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No. 6 and 7

In the Supreme Court of the United States

OCTOBER TERM, 1945

AMERICAN POWER & LIGHT COMPANY, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ELECTRIC POWER & LIGHT CORPORATION, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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OPINIONS BELOW

The opinion of the United States Circuit Court of Appeals for the First Circuit (R. 869–899) is reported at 141 F. 2d 606. The findings and opinion of the Commission (R. 523–672), are reported at 11 S. E. C. 1146.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered March 17, 1944 (R. 900–901). The

petitions for writs of certiorari were filed June 16, 1944, and granted May 28, 1945 (R. 901). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, which is made applicable by Section 24 (a) of the Public Utility Holding Company Act of 1935 (15 U. S. C. § 79 x (a)).

QUESTIONS PRESENTED

1. Did the Commission properly find that the corporate structures and continued existence of petitioners unduly and unnecessarily complicate the structure of the Electric Bond and Share holding company system and unfairly and inequitably distribute voting power among the security holders of that system?

2. Did the Commission properly order dissolution of petitioners?

3. Is Section 11 (b) (2) of the Act constitutional as applied to petitioners?

4. Did the Circuit Court of Appeals properly refuse to pass on questions not raised before the Commission? If not, is there any merit to such contentions?

STATUTE INVOLVED

The statute involved is the Public Utility Holding Company Act of 1935 (Act of August 26, 1935, c. 687, Title I, 49 Stat. 803, 15 U. S. C. § 79 *et seq.*), herein referred to as the "Act". The respondent's order was made under Section

11 (b) (2) of the Act. The relevant provisions of the statute are set forth in Appendix A, *infra*, pp. 167–183. The background of the statute is described in the Commission's brief filed in this Court in *North American Company* v. *Securities and Exchange Commission*, No. 1,[1] at pp. 3–11.

STATEMENT[2]

1. *The Electric Bond and Share Company holding company system*

This Court has previously had occasion to consider certain aspects of the Electric Bond and Share Company holding company system and of the petitioners' relationships thereto.[3] *Electric Bond and Share Co.* v. *Securities and Exchange Commission*, 303 U. S. 419. In that case, which tested the constitutionality of the registration pro-

[1] Inasmuch as argument in the instant cases will be heard together with the arguments in the *North American* case and in *Securities and Exchange Commission* v. *Engineers Public Service Company, etc.*, Nos. 2 and 3, which also involve Section 11 of the Act, reference is made to the briefs submitted by this Commission in those cases to avoid undue repetition. These briefs will be referred to respectively as "our North American brief" and "our Engineers brief."

[2] Except where other reference is made, the facts are taken from the Commission's opinion (R. 523–672) the factual basis of which was not disputed by the petitioners. See pages 20–21, *infra*. Unless the contrary is indicated the brief speaks as of the time the record was closed.

[3] Electric Bond and Share Company is hereinafter referred to as "Bond and Share." Petitioners American Power and Light Company and Electric Power and Light Corporation are referred to respectively as "American" and "Electric."

visions of the Act, the Court pointed out the "highly important relation to interstate commerce and the national economy" (p. 441) of constituent companies of the Bond and Share system, including these petitioners, which were defendants therein. The stipulation which underlay the findings in that case has been specifically incorporated in the present record,[4] which includes also substantial additional data descriptive of the system.

The Bond and Share system is a pyramid-like structure of which Bond and Share itself constitutes the apex, five subholding companies (including the petitioners herein) create an intermediate tier, and approximately 237 direct and indirect subsidiaries of the latter form the base (R. 535). It is the largest public utility holding company system registered under the Act in point of book capitalization and assets, number of customers and areas served, and quantity of electricity generated and gas sold (R. 535–536). Its combined consolidated capitalization and aggregate book assets approximate $3,000,000,000.[5] In the

[4] R. 171; Comm. Ex. 68a–f.

[5] The capitalization and surplus of Bond and Share as of December 31, 1941, are stated on its books as follows (R. 536):

	Stated value
Capital Stock:	
$5 Preferred Stock, no Par	$28,030,000
$6 Preferred Stock, no Par	110,195,500
Common Stock, $5 Par	26,251,788
Surplus:	
Capital Surplus	316,504,930
Earned Surplus	63,116,392
Total Capitalization and Surplus	544,098,610

United States it supplies electricity or gas to more than 2,300 communities having a total population of some 12,000,000 and located in 32 states (R. 536).* In addition, electricity or gas is supplied to 1,021 communities located in 12 foreign countries, principally in Cuba and Central and South America (R. 536).

The generation of electricity and manufacture of gas and the distribution and sale thereof are carried on exclusively by the operating companies at the base of the pyramid. As described by this Court, some of these companies "operate only within a single State, some in two or more States, transmitting energy across state lines for their own account, and some sell energy at wholesale in interstate commerce." *Electric Bond and Share Company* v. *S. E. C., supra,* at p. 432.

The capitalization of these operating companies consists generally of bonds and preferred stocks, which are owned mainly by the investing public, and common stock, which is almost wholly owned by one or another of the subholding companies (R. 659–660). The subholding companies have capital structures consisting in the main of debentures, preferred stocks, and common stocks. Almost all the senior securities and, except in case of Electric, most of the common stock of these subholding companies are held by the investing public. In all instances control over the subholding companies and their subsidiaries is exer-

*See maps contained in Appendices B and C, *infra.*

cised by Bond and Share through a minority of the voting rights appurtenant to the stocks of the subholding companies (R. 614, 615–618, 658).[7] Despite its minority interests Bond and Share retains sufficient voting power to have effective control over the subholding companies, and through their ownership of the voting securities of the operating companies over all the operating companies of the system (R. 615–618). In the case of petitioners and their operating subsidiaries the control is complete and pervasive.[8]

[7] Bond and Share's holdings of common stock range from 18.9% in the case of American Gas & Electric to 57.3% in the case of Electric, and its voting power ranges from 17.5% to 46.8% (R. 614).

[8] See Chart contained in Appendix D.

Control by Bond and Share of the subholding companies (except American Gas and Electric, as to which see note 10, *infra*), as well as control by the subholding companies of their subsidiaries, has never been denied or put in issue. Not only is there a statutory presumption of control in Section 2 (a) (7) and (8) of the Act (see *Morgan, Stanley & Co.* v. *S. E. C.*, 126 F. 2d 325 (C. C. A. 2d (1942)), but the Commission expressly found such control to exist. The Commission found, for example (R. 615):

"* * * the record of the present proceeding establishes that Bond and Share's control is complete and pervasive.

"This control of the subholding companies by Bond and Share is not limited in operation to the mere casting of a certain percentage of votes at stockholders' meetings. It permeates every stratum and unit of the holding company system in the most comprehensive manner."

See also the testimony of American's president: "There is no question in my mind that Bond and Share is in control of American today, sir. We have admitted it." (R. 279).

Bond and Share is the top holding company in the system. Its assets, exclusively securities and cash, consist largely of common stocks in the five subholding companies which in turn hold only securities of the operating companies or of other subholding companies. The present petitioners, American and Electric, are two of these subholding companies which are direct subsidiaries of Bond and Share, the other three being National Power & Light Company,[9] American Gas and Electric Company,[10] and American & Foreign Power Company, Inc. (R. 535.)

Bond and Share also owns all of the securities of Ebasco Services Incorporated,[11] a service company (R. 596). Through it Bond and Share renders services to all the operating subsidiaries of American and Electric. Ebasco was organized in November 1935 to continue functions formerly carried out by the Bond and Share service department (Comm. Ex. 68a, p. 353). At that time Bond and Share's service contracts with the operating

[9] See pp. 19–20, *infra*.

[10] American Gas and Electric Company alone, among the subsidiaries of Bond and Share, appears to have had a certain amount of autonomy in the management of its affairs. However, its application to the Commission to be held not a subsidiary of Bond and Share was denied on the ground that it had not established that it was not subject to a controlling influence. *American Gas and Electric Company*, 9 S. E. C. 247 (1941), affirmed, *American Gas and Electric Company* v. *S. E. C.*, 134 F. 2d 633 (App. D. C.), certiorari denied, 319 U. S. 763.

[11] Hereinafter referred to as "Ebasco."

subsidiaries were assigned to Ebasco (*id.*, p. 355) and substantially all the employees of Bond and Share who had been engaged in servicing operating subsidiaries were transferred to Ebasco (*id.*, p. 359). Both Bond and Share and Ebasco are incorporated in New York (R. 549, Comm. Ex. 68a, pp. 352–353). From its central offices in New York City Ebasco makes purchases for and directs the shipment of equipment and accessories to the operating companies, none of which conduct their operations in New York State. Ebasco supervises the preparation of budgets for all the operating companies. It places insurance for them, advises on their accounting and engineering practices and procedures, assists in their sales campaigns, rate proceedings and tax returns, prepares reports to stockholders and others and advises and assists upon myriads of other problems. In connection with these activities a continuous stream of inquiries, instructions and reports borne by mail, wire and field representatives, travels back and forth between the home office in New York and the operating companies scattered throughout the United States. (Comm. Ex. 68a, pp. 362–384).[12]

[12] As pointed out in the opinion of the Court in *Electric Bond and Share Company* v. *S. E. C.*, *supra*, at p. 432:

"The performance of service contracts by Ebasco, operating as a subsidiary and on behalf of Electric Bond and Share Company, constitutes an extensive business in rendering continuous expert, specialized, and technical service, advice, and assistance to the serviced companies upon every phase of the utility enterprise."

American and Electric perform no services of significance for their subsidiaries, and their only function is to serve as conduits or instrumentalities for Bond and Share's control of the operating properties. Petitioners are Maine corporations organized by Bond and Share in 1909 and 1925, respectively. They were created and continued as devices by which Bond and Share could obtain or retain control over operating companies with a minimum of investment. They were used as a means of obtaining funds from the public by the sale of their own securities in amounts sufficient to pay for control of operating companies. Since in many instances controlling securities of these operating companies were already owned by Bond and Share, the result was that Bond and Share was reimbursed for its investment in these companies, often with a handsome profit, while it still retained control over the enterprise. (R. 554–600.)

Until 1935 American and Electric had no offices and needed none because they had no employees. Their books were kept by Bond and Share employees in Bond and Share's offices in New York along with those of Bond and Share's other "paper" companies. Their officers were employed by Bond and Share and were paid exclusively by Bond and Share. (R. 561–562, 592.)

In November, 1935, after the enactment of the Public Utility Holding Company Act of 1935, but shortly before the effective date of the registra-

tion provisions, Bond and Share detailed a small group of its employees to act solely as the new officers and as clerical personnel of each of its subholding companies, including the petitioners. Each subholding company with its newly assigned staff was then established in a small suite of offices in the Bond and Share office building in New York City, adjacent to those of Bond and Share and its wholly owned service subsidiary, Ebasco. Other superficial changes in the Bond and Share organization were made at the same time, none of which worked any fundamental change in Bond and Share's complete and pervasive control of American and Electric and all their operating subsidiaries. The personnel with whom Bond and Share staffed these companies still constitute their managements, and their boards of directors are comprised of officers of the companies and other persons selected by Bond and Share. (R. 592–598.)

The main steps in the creation of the Bond and Share system and the role which American and Electric played in its development are reviewed in the Commission's findings (R. 549–600). The Commission described the origin of the Bond and Share system as follows (R. 549–550):

> Bond and Share was organized under the laws of New York on February 27, 1905, by the General Electric Company, a leading manufacturer of electrical equipment. General Electric's purpose in the formation of

> Bond and Share seems to have been threefold: (1) to realize as fully as possible upon various utility securities which it had acquired in the process of selling its equipment; (2) to obtain for itself a direct proprietary stake in a promising young industry with which it was already closely affiliated; (3) to utilize the position it would acquire as a proprietary factor in the utility industry to advance the sales of its equipment.

Over a twenty-year period General Electric made a book investment of approximately $25,000,000 in Bond and Share in exchange for which it obtained the entire common stock of that company. In return it received more than $13,000,000 as cash dividends and in 1925, when General Electric disposed of its investment in Bond and Share, the market appraised its value at about $117,000,000.[13] (R. 550.)

The Commission's review of the various promotional activities which built up the system em-

[13] In December 1924, Senate Resolutions had been introduced directing the Federal Trade Commission to investigate General Electric's relationship to the electric power industry and shortly thereafter the board of directors of General Electric voted to "divorce" itself from Bond and Share. This objective was carried out by the declaration of a dividend to General Electric stockholders of shares of a new company set up to hold all the stock of Bond and Share. The new company was consolidated and merged with the old Bond and Share in 1929 to form the present company. The merger involved a write-up of approximately $400,000,000 which was followed by a write-down of $441 000 000 two years later. (R. 551–552.)

phasizes the dominance of a single personality, Sidney Z. Mitchell, and his successful realization of a financial method—largely dependent upon using the subholding companies as pyramiding and leverage devices—whereby Bond and Share could successively expand its control over the growing public utility industry with a minimum investment. This pattern was evidenced from the very beginning. (R. 552–553.) As early as the year following the creation of Bond and Share, American Gas and Electric was organized as a subholding company. Although that company is not involved in the present proceeding, the promotional steps followed in its organization are mentioned here as typical of the pattern of financial practices followed by Bond and Share in the organization of its other subholding companies including petitioners. Bond and Share made no permanent investment but "emerged with a profit of $30,000 cash and 4,700 shares of the company's common stock (having a par value of $235,000) equal to approximately 9.5% of the total voting securities * * *" (R. 553), as well as heavy representation on the board of directors and executive committee of the new company.

By the promotion of petitioner American, in 1909, Bond and Share realized cash profits of approximately $120,000 and emerged with cost free holdings of 29.47% of the common stock outstanding (representing 20% of the voting securities, carrying completely effective control of the new

company) (R. 554–558). American, on the other hand, had issued $8,000,000 par value of its own securities and had received in return therefor only $500,000 in cash together with securities which had recently cost Bond and Share less than $1,700,000 (R. 558). The Commission's review of the subsequent growth of American and its relations with Bond and Share recounts a series of transactions in the course of which American's capitalization increased by 1929 to $263,101,529, and its consolidated assets to $754,129,787 (R. 560–564). In the late twenties American paid enormously high prices in relation to underlying earnings and assets to acquire controlling stocks of established utilities; these transactions were usually effected by exchanges of securities, and a total of $164,000,000 of American's preferred stock was thus issued (R. 560–561, 566–567). Appendix G to the Commission's findings (R. 668) shows in tabular form the manner and costs of Bond and Share's acquisition of common stock of American, including the cash cost to an affiliated company later merged with Bond and Share. The total cash cost was but $10,880,250.30, of which over eight million dollars represented open market purchases the bulk of which occurred after the market crash in 1929 (R. 567).[14]

Electric was organized in March of 1925 to acquire two "baskets" of securities previously held by Bond and Share. In consequence of the

[14] See page 41, *infra*, for the capitalization of American.

promotional activities described in the opinion (R. 572–578) Bond and Share emerged with complete control achieved through 16% total voting power, holdings of "298,341 shares of common and 353,408 option warrants at no cost, 9,480 shares of second preferred stock at a cost of $854,904, and a net cash profit of approximately $6,500,000 on the securities surrendered to Electric, most of which had been held less than two years" (R. 578).

Electric in turn started off with an investment account stated on its books at $69,900,000 of which $46,655,352 represented write-up over cash cost of affiliated predecessors. Thus, there was no true cushion for the public investors who paid $40,000,000 for preferred stock of Electric. (R. 582–583.) As in the case of American, subsequent transactions involved use of the subholding company to finance acquisitions of additional operating company common stock (R. 583–592).[14a]

In one of the major transactions, acquisition of control of the Harvey Couch and other properties in Arkansas, Louisiana and Mississippi, Electric was successful in recouping its cash outlays and disbursements through resale to the public of senior securities of operating subsidiaries, leaving it with $26,500,000 stated value of second preferred and common stocks of subsidiaries for an initial investment cost of $10,800,000 stated value of its own securities (R. 583–586).

[14a] See page 44, *infra*, for the capitalization of Electric.

The other major transaction subsequent to the initial promotion of Electric involved the promotion of United Gas Corporation. This represented an exceptional instance where Bond and Share and the subholding company were forced to tie up substantial funds in the venture because market conditions precluded obtaining the necessary funds by a sale to the public of senior securities of the operating Company. Bond and Share made large loans, some of which were repaid directly or indirectly by means of cash supplied by Electric, and emerged at the conclusion of the financing with a $52,000,000 6% debt claim purportedly senior to the public investment in United Gas preferred stock as well as to Electric's investment in United Gas. Electric's own investment of over $60,000,000 in cash, plus securities stated on the books at $27,400,000, was represented by second preferred, common stock and option warrants of United. In connection with raising this cash Electric made a public sale of $31,000,000 of its debentures and $20,000,000 stated value of preferred stock. There was an attempt to raise additional funds from the public through an offering of rights to buy additional common stock of Electric, underwritten by Bond and Share. The offering was largely unsuccessful and Bond and Share was forced to make an aggregate investment on its direct subscription and as underwriter of $20,500,000. Although United Gas needed large sums for additional con-

struction and development, Electric's initial investment did not serve to supply this needed capital but was used to buy out at prices disproportionate to book assets those in control of predecessor companies. The fact that United Gas was thus initially launched with inadequate capital furnished the occasion for the Bond and Share advances on open account and also gave rise to future controversy over the status of its debt claim.[15] (R. 586–591.).

Apart from Bond and Share's involuntary subscription to Electric's stock in connection with United Gas Corporation transactions, it made no contribution to the capital of Electric. Its only other investment in Electric's common stock involved over $12,000,000 of open market purchases after the market crash in 1929 and 1930 (R. 591–592). (See Appendix G to Commission's findings, R. 669).

2. *Proceedings Below*

On May 9, 1940, the Commission instituted the proceeding now under review by the entry

[15] Subsequent to the closing of the record this was settled by a compromise payment pursuant to a plan approved by the Commission under which Bond and Share received $44,000,000 for this claim and other securities of United Gas held by it. See pp. 112–113, *infra*. This plan was negotiated subsequent to the Commission's institution of proceedings "to ensure a comprehensive investigation * * * of the respective claims and equities of its [United Gas'] various security holders * * *". *United Gas Corporation et al.*—S. E. C.—(1944), Holding Company Act Release No. 5271, pp. 10–11.

of a notice and order for hearing to determine what steps had to be taken by Bond and Share and its subsidiaries to comply with Section 11 (b) (2). One of the issues specifically stated was "whether it is necessary to discontinue the existence of * * * Electric Bond and Share Company or any of the other respondents." (R. 50.) The respondents in the proceeding were Bond and Share, its five major subholding companies (including the two petitioners herein), two *sub*-subholding companies and Ebasco Services Incorporated (R. 27, 30). In response to respondents' objections and requests relating to the scope of the issues, problems relating to American & Foreign Power Company and American Gas and Electric Company which appeared to involve different considerations from those relating to the other sub-holding companies were severed from the proceeding[16] and the hearing was initially confined to the sole issue of whether it is necessary to discontinue the existence of American, Electric, and National Power and Light Company or any of them.[17]

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[16] American Gas and Electric was dropped by the order dated June 7, 1940 (R. 64–66); American & Foreign Power was dropped by order dated June 17, 1940, referred to at R. 395 and published as Holding Company Act Release No. 2118.

[17] See order of June 7, 1940 (R. 64–66). Electric complains that the issues were so framed "as to make it appear either that nothing could be done with respect to the Bond and Share system pursuant to Section 11 or that Electric

In view of petitioners' statements as to the scope of the issues so raised we refer the Court to Section 2 (a) (9) of the Act, which defines a holding company system as "any holding company together with all its subsidiary companies * * *." Thus, while it is proper to refer to the American and Electric systems as separate holding company systems, the Bond and Share system includes both the American and

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must be dissolved. No alternatives were to be considered." (Brief p. 7; see also p. 35.) Electric neglects to point out that the order of May 19, 1940, limited the issues "initially" to be considered and did not preclude consideration of alternatives in the event that the initial issues should be resolved favorably to the respondents. Nor is it pointed out that this narrowing of the scope of the issues was in response to respondents' objections.

The original notice (dated May 10, 1940) included the following statement of issues (R. 50):

"(2) whether it is necessary to discontinue the existence of, or modify the corporate structure of, or redistribute the voting power among security holders of, said Electric Bond and Share Company or any of the other respondents herein; (3) what further action, if any, is necessary and shall be required to be taken by the respondents herein, or any of them, in order that each of the respondents herein which is a registered holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company, and (4) what further action, if any, is necessary and shall be required to be taken by the respondents herein, or any of them, to ensure that the corporate structure or continued existence of any of the respondents herein does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of the holding company system of Electric Bond and Share Company."

Electric systems as well as the systems of other subsidiary holding companies. Likewise, the term security holders of the Bond and Share system includes holders of securities in petitioners and their operating subsidiaries as well as security holders in Bond and Share. Statements in the briefs of petitioners evidence a correct understanding of this distinction, e. g. Amer. Br., pp. 7, 17, 93, 115, Elec. Br., p. 5. Nevertheless it is elsewhere incorrectly stated that the issues included solely the effect of or position of petitioners in the Bond and Share system and not their position or effect within their own systems (Amer. Br. p. 9; Elec. Br., p. 35). The implication is that the Commission could not consider the impact of their corporate structure and existence upon security holders of petitioners, or of petitioners' subsidiaries. This seems largely a play on words.

During the course of the hearing, in August 1941, the record as to National Power and Light Company was by stipulation deemed closed. The Commission thereupon issued its findings and opinion in which it found that the corporate structure and continued existence of National Power and Light Company unduly and unnecessarily complicated the structure and unfairly and inequitably distributed voting power among security holders of the Bond and Share system. *Electric Bond and Share Company et al.*, 9 S. E. C. 978. An order was entered requiring the dissolution of National. Holding Company Act Release No.

2962. National did not appeal and is proceeding to liquidate in accordance with the Commission's order.[18]

In July, 1942, the record, comprising more than 18,000 pages of testimony and more than 1,500 exhibits, was by stipulation deemed closed as to petitioners (R. 297). A stipulation as to procedure would have afforded respondents 25 days in which to except to proposed findings of the Commission, and 15 days for reply by the Commission's staff (R. 295). This procedure was later telescoped by the agreement described below and on August 22, 1942, the Commission issued its findings that the corporate structure and continued existence of both American and Electric unduly and unnecessarily complicated the structure and unfairly and inequitably distributed voting power among the security holders of the Bond and Share system; and that their corporate structures had the same effect in their own systems (R. 635). Orders were entered requiring that the existence of American and Electric be terminated and that these companies be dissolved. They directed Bond and Share, American, and Electric to proceed with due diligence to submit plans for the dissolution of American and Electric. (R. 650–655.)

At the conclusion of the hearing the petitioners had waived a trial examiner's report (R. 297). Copies of the Commission's proposed findings,

[18] See *infra*, pp. 117–120, as to the progress National has made in this respect.

opinion, and orders with respect to petitioners were then submitted to petitioners in advance of their adoption and after examining these the petitioners stipulated that they did not desire to file exceptions to any of the findings (R. 520–22). They stated that their objections were ruled upon by the Commission in its findings, opinion and order (R. 521–22). Similarly, in petitions for rehearing filed on August 27, 1942 (R. 673–676), petitioners stated that the grounds for rehearing and their contentions with respect thereto "have been fully stated in the record and are dealt with by the Commission in said findings and opinion" (R. 674, 676). As the court below in effect held (R. 875, 879), the consequence of this procedure was that petitioners accepted without challenge the Commission's findings as an adequate statement of the facts shown by the record, and of the contentions which the petitioners had made before the Commission.

In its opinion the Commission stated the major issues to be: (1) whether the structure of the Bond and Share holding company system is unduly and unnecessarily complicated, or whether voting power is unfairly and inequitably distributed among the security holders of the system; (2) if so, whether such conditions are to a substantial extent attributable to the continued existence or capital structure of petitioners or either of them; and (3) whether it is necessary to discontinue the existence of petitioners or

either of them to remedy these conditions in the manner contemplated by the statute (R. 533). The Commission decided each of these issues in the affirmative and ordered the dissolution of petitioners.

In addition, the Commission specifically rejected the following contentions of petitioners as well as others not now at issue: (1) that it should dismiss the proceedings on the ground that Section 11 (b) (2) of the Act is unconstitutional; (2) that the Commission was powerless to proceed with the hearing in this proceeding except after completion of or in conjunction with its proceeding under Section 11 (b) (1) of the Act; (3) that the Commission had not made the examination and investigation contemplated by Section 11 (a); (4) that certain evidence offered by American, bearing on valuation of assets, was improperly denied admission; and (5) that certain applications of petitioners under Section 11 (e) of the Act for approval of plans for compliance with Section 11 (b) of the Act should be consolidated with this proceeding (R. 529–533).

On August 28, 1942, the Commission denied the petitions for rehearing. Shortly thereafter, both petitioners advised their security holders that in the light of the necessity for reorganization of petitioners regardless of the orders, they intended to comply, and that they had no intention of appealing. On the 59th day after the entry of the orders, both petitioners filed their petitions

for review. These raised the various questions which had been urged before the Commission and in addition contentions not raised before the Commission.

The court below refused to consider the contentions not raised before the Commission (R. 875–876) but upon examination of all contentions it deemed properly raised, it sustained the Commission in all respects and affirmed its orders (R. 869–901).

3. *Nature of the issues raised in this Court.*

Petitioners' arguments that Section 11 (b) (2) is not a valid exercise of the commerce power are substantially the arguments which have been advanced in the *North American* case, both by North American and by petitioners as *amici curiae*. These arguments have been dealt with at length in our *North American* brief. Petitioners' further constitutional contentions as to want of due process, substantive or procedural, are interrelated with challenges to the Commission's application and interpretation of the statutory standards, to its inferences from the undisputed facts and to its choice of remedy. These contentions are also based upon what we consider wholly unfounded assumptions as to the practical consequences of the dissolution orders. For that reason we shall deal with them in our discussion of the factual basis of the Commission's findings and the considerations pertinent to its choice of remedy.

SUMMARY OF ARGUMENT

I

The Commission found that the corporate structure and continued existence of petitioners, intermediate holding companies in the Bond and Share system, unduly and unnecessarily complicate the system and unfairly and inequitably distribute voting power among the security holders of that system. The conclusion rests upon what were virtually undisputed findings of facts. Moreover the petitioners have in the past conceded that they violate the statutory standards and that reorganization or dissolution is necessary. Apart from constitutional arguments their main contention is that the remedy of dissolution is unduly drastic.

The facts demonstrate the need for action. American and Electric, it was clearly established, are means by which Bond and Share controls the subsidiaries of American and Electric through disproportionately small investment. The findings of the Commission are based on violation of the statutory standard both on the ground that petitioners unfairly and inequitably distribute voting power and on the ground that they unduly and unnecessarily complicate the structure of the Bond and Share system. That system includes by definition the petitioners and their subsidiaries.

On the score of voting power, the unchallenged figures show that Bond and Share, through American, controls the subsidiaries of American by means of an investment of approximately 3.42%

of the book value of American subsidiaries, while the holders who have contributed over 96% of the investment in those subsidiaries are disfranchised. In the case of Electric, control is exercised through ownership of securities representing only 8.72% of the book values of Electric's subsidiaries, while the holders who contributed over 91% of the book investment in those subsidiaries are disfranchised. The extent of Bond and Share's interest is subject to further diminution since these computations do not take into account the fact that the book figures reflect unconscionable writeups and inadequate depreciation.

Petitioners' challenge to the validity of the Commission's figures involves only the adjustments for such indicated writeups and depreciation. On analysis, the post-record transactions cited by petitioners substantially sustain the Commission's findings. The transactions mentioned indicate with relation to writeups that the Commission's assumptions on this score have been substantially borne out. They have no relevance to the Commission's comments as to inadequate depreciation, since the later transactions referred to do not attempt to pass on the adequacy of depreciation reserves.

American's attempt to offer valuation testimony could have no effect on the Commission's conclusion concerning inequitable distribution of voting power, since the inequity was amply demonstrated otherwise and the proposed proof, if accepted,

would have made only an insignificant difference in the figures on which the Commission based its conclusion. The Commission did not err in comparing for purposes of its analysis the securities through which Bond and Share exercised its control with the entire investment in the system. It was not required to include in its computations holdings of Bond and Share through which control was not exercised and it was not required to ignore the vast amount of the capitalization of its subsidiaries which was represented by debt securities.

The record also shows that petitioners caused major complexities in the Bond and Share system. Their sole function in the system was to serve as pyramiding and leverage devices which produced most of the major evils at which the statute was directed. The complications were present throughout the system and involved threats to the efficiency of public regulation, to the safety of investors, and to the making of rate reductions. At the levels both of petitioners and of Bond and Share, they represented particularly serious dangers to investors.

Further, there was no justification for the continued existence of petitioners. Petitioners were mere paper companies having no function whatsoever as to operating matters, all such matters being carried out by Bond and Share through its service company irrespective of theoretical ownership and control of such properties by petitioners. The petitioners have no staffs capable

of performing operating functions, whereas petitioners' subsidiaries and Bond and Share's service company have adequate staffs and in fact perform all functions with relation to operations. Moreover, petitioners serve no function with respect to financial matters. Nor have they ever served such a function in the past except the type of function which the statute condemns. The acquisition and combination of properties was accomplished by Bond and Share or by other companies, and the properties were placed in petitioners solely as a means whereby Bond and Share could sell securities to investors and recoup its own investment without losing control of the operating companies. The few occasions on which petitioners made outlays in connection with the combination of operating companies were purely transitional and the outlays were not at all in the nature of equity capital. Petitioners were of no further aid to their subsidiaries subsequent to their organization. Almost all the capital which has gone into the development of subsidiaries was supplied by the public investors in those subsidiaries. The record does not even sustain a claim that such short-term loans as petitioners made were of assistance to their subsidiaries.

II

In the light of the nature of petitioners' violation of the statutory standards the Commission found that their dissolution was "necessary to

ensure" that those violations be corrected. It found that no other approach "holds out the promise of effectuating the statute's requirements fully or promptly". Indeed, dissolution of intermediate holding companies was recognized by one of the investigators upon whom Congress relied, Dr. Walter Splawn, as perhaps the most appropriate means of achieving the legislative objectives. The Commission's choice of dissolution was an eminently fair and practical solution to a complex administrative problem. Section 11 (b) orders are not self-enforcing. They merely fix an objective toward which the company is directed to work during the period for compliance and which in default of compliance can be enforced by a court-appointed trustee. The purpose of the order is to fix the necessity for action and to avoid delay.

Dissolution is not, as petitioners urge, an injury to investors. Rather it involves the placing of investors in a sounder position by removing useless and costly intermediate holding companies. Such a process gives security holders a direct interest in the operating companies in lieu of their existing indirect interest through the stock of petitioners. The result will be beneficial to investors and will result in the correction of financial conditions which have been detrimental to consumers and to the public interest in general. In fact, the process of compliance with a dissolution order is one which impels substantial im-

provement of the financial structure of petitioners' operating company subsidiaries as well as correction of the complexities of petitioners' own structure. This process is one which has been followed with profit by National Power and Light Company, a sister holding company of petitioners. Petitioners, notwithstanding their challenge to the present orders, have accomplished a partial liquidation as a result of which they have enormously strengthened the financial position of their subsidiaries and increased their equities in those subsidiaries. Compliance with a dissolution order must be made in accordance with the "fair and equitable" standards contained in the Act, and the experience of the Bond and Share system has shown that the process is one which is in all respects beneficial to the public interest and the interest of investors and consumers, and such was the finding of the Commission.

Alternative solutions are suggested by petitioners. First, it is suggested that Bond and Share is the principal offender against the statutory standards, and that the Commission should merely have required Bond and Share to divest itself of its interests in petitioners. But irrespective of any fault of Bond and Share as the creator, it was the continued existence of petitioners, not of Bond and Share, which the Commission found to be the major instrument in the violation of statutory standards. Moreover, such an order would be only a partial solution and subject to

substantial objections on the ground that reorganization of petitioners and petitioners' subsidiaries would be an essential prelude to the creation of any type of security which Bond and Share could properly be authorized to distribute. Petitioners have also suggested that if their capital structure were corrected to the point that they did not offend against the statutory standards, and if they were limited to a single integrated system and such other properties as might be retained under Section 11 (b) (1) of the statute, dissolution would not be necessary. But there was no assurance that even after reorganization there would be any single integrated system to which it would be permissible for either of petitioners to limit itself. American has practically recognized this fact. Electric, however, claims a "Southern" system. Electric's alleged southern system originally included both the gas properties of United Gas Corporation with over $309,000,000 of book assets and the properties, chiefly electric, of other subsidiaries aggregating over $236,000,000 of book assets. On size consideration alone the Commission questioned whether such a combination of properties could be held in a single holding company system. It was by no means certain that Electric had sufficient investment in that system to be permitted to serve as an agency to keep it or any part of it together. The Commission pointed out that if a holding company was needed to keep any such

system together, nothing made Electric, a Maine corporation, superior to a specially incorporated company with a more appropriate domicile created for that purpose. It was within the discretion of the Commission to order the dissolution of petitioners, as presently offensive to the standards of the Act, rather than to order such a complete transformation as would endow them with management, appropriate function and independence, in addition to appropriate capital structures. The orders, however, in no way preclude petitioners and Bond and Share from themselves bringing about such a transformation and in that event obtaining appropriate modification of the orders. Electric's argument that every holding company is entitled to a single system ignores the applicability of Section 11 (b) (2) as well as Section 11 (b) (1). Under Section 11 (b) (2) useless, complex and unnecessary holding companies may be dissolved even though the properties on which they are erected are only a single integrated system. The Commission's choice of a remedy was a rational one designed to ensure compliance and highly salutary in its effect on investors.

Petitioners' plans filed with the Commission are no bar to a dissolution order, since they do not offer any promise of effectuating compliance with the statute by other means than dissolution. The plans were seriously incomplete and ineffective and the Commission indicated that they would

be dismissed if they were pressed. However, petitioners have not pressed these plans except to argue that they are bars to dissolution orders. In fact, the companies, no less than the Commission, have apparently regarded the plans as merely litigation strategy and have devoted their time to many other more limited proposals which have in fact been approved and consummated and have carried petitioners far along the road to compliance.

III

There is no constitutional objection to the Act as applied to petitioners. The structure of the Act has been analyzed in our North American and Engineers briefs; we have there shown that Section 11 was designed to apply only to the typical interstate holding company, and that the Court need not here be concerned lest as applied to some other company the Act might be too inclusive. That petitioners are typical interstate holding companies is clear. Indeed, petitioners have no local functions. They are exclusively instrumentalities of interstate commerce and interstate control through which Bond and Share controls a substantial part of its nation-wide system of operating companies. They reflect all the complexities and evils recited in the Act as spread by and having adverse effects upon interstate commerce. Reorganization of the financial structure of a typical interstate holding company is as closely related to the interstate commerce in which that

company is engaged as is reorganization of an interstate railroad company to the commerce in which the railroad is engaged. *Ecker* v. *Western Pacific Railroad Corp.*, 318 U. S. 448, 474. No separate problem is presented by the remedies contained in Sections 11 (b) (1) and 11 (b) (2), since they merely provide somewhat different remedies for the same evil. No objection under the due process clause can be advanced on the ground that petitioners are being subjected to "compulsory involuntary reorganization" since this sanction is common under the commerce clause in the antitrust cases. Similarly, the Act is not improperly retroactive, for it simply provides remedies for conditions which in the judgment of Congress have become intolerable. Compliance looks to the future, as in cases under the antitrust and Hepburn Acts, though the objectionable arrangements may have antedated the statute. The Act takes no property, and in fact compliance may well be highly beneficial from a financial standpoint. Section 11 is not vulnerable on the ground of undue delegation of power, since the standards set forth are clear in themselves and in the context in which they are embodied. Indeed the argument that the standards of the Act are too indefinite is somewhat strange, since petitioners' president, along with other holding company executives, urged that the most general standards be adopted by Congress and that the Commission not be placed in a "strait-jacket".

IV

Petitioners raised before the circuit court of appeals certain questions not raised before the Commission. Section 24 (a) of the Act provides that no objection to the order of the Commission shall be considered by the court unless such objection shall have been *urged before the* Commission or unless there were reasonable grounds for failure to do so. On the basis of this section the court below refused to consider those arguments and we believe properly. No reasonable ground was advanced for failure to raise the contentions before the Commission.

Of the contentions raised in the court below and not raised before the Commission, petitioners now urge only that the Act does not grant the Commission the power in any case to order the dissolution of a holding company. The language of the statute clearly gives the Commission authority to terminate the business of holding companies and to order their elimination. Section 11 (b) (2) gives the Commission power to require any action, including that of dissolution, which it finds "necessary to ensure" conformity to its standards. Petitioners argue that elision of an earlier reference to "dissolution" means the withdrawal of the power to dissolve. But the substitution of the present very general language of Section 11 (b) (2) indicates unmistakably that it was intended to broaden rather than limit the Commission's power. In fact the Commis-

sion has consistently and without question exercised the power of ordering dissolution in the case of a number of major holding companies, including National Power and Light, petitioners' sister company. If petitioners are nevertheless entitled to a ruling on this contention it should be by this *Court, and not by remand which* would result in further delay.

ARGUMENT

I

THE COMMISSION PROPERLY FOUND THAT THE CORPORATE STRUCTURES AND CONTINUED EXISTENCE OF PETITIONERS UNDULY AND UNNECESSARILY COMPLICATE THE STRUCTURE OF THE BOND AND SHARE SYSTEM AND UNFAIRLY AND INEQUITABLY DISTRIBUTE VOTING POWER AMONG THE SECURITY HOLDERS OF THAT SYSTEM

The Commission's conclusion that the corporate structure and continued existence of petitioners unduly and unnecessarily complicate the Bond and Share system and unfairly and inequitably distribute voting power among the security holders of that system rests upon what is virtually an agreed statement of facts set forth in the Commission's opinion.[19] An examination of those facts in the light of

[19] The failure of petitioners to question in the administrative proceeding the factual basis for the Commission's finding makes wholly unwarranted American's criticism of the court below for alleged lack of "dispassionate consideration to the questions presented" which American purports to derive from the fact that the opinion below contained copious quotations from the "heated declarations of the S. E. C." (Amer. Brief, p. 20). By the same token Electric's reference to "the shocking extent to which the 'facts' respecting Electric are misstated by the Commission's opinion" implies

the standards of the Act will, we submit, establish the accuracy of the Commission's conclusions. As we have noted above, those conclusions were severally applicable under the statutory definition of "holding company system" both to the Bond and Share system in its entirety and to the major segments of that system constituting the American and Electric systems.

It is not clear that petitioners seriously dispute the findings that they violate the statutory standards. At most, they attempt to show through various challenges to the Commission's analysis that it overstated the degree of their offensiveness. But their own statements concede the necessity for drastic reorganization. In their brief in *Electric Bond and Share Co.* v. *Securities and Exchange Commission,* 303 U. S. 419, it was stated (p. 110) that "the Act directs the Commission to require all the major holding company defendants (with the possible exception of

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a shocking lack of diligence on the part of petitioners and their counsel in failing to call any inaccuracies to the attention of the Commission, if there were in fact any misstatements (Electric Br. p. 39). We show below, however, that the purported illustration of misstatements involves nothing more than an argument based upon the fact that the Commission did not later require subsidiaries of petitioners to increase depreciation reserves to the amount claimed for tax purposes. This is argued to evidence inaccuracy in a tabular statement and other computations (not disputed before the Commission or now) showing the difference between depreciation which petitioners recorded on their books and reports to security holders and depreciation claimed for income tax purposes. (See *infra*, p. 56–59.)

American Gas) to reorganize or dissolve." In their answers to the complaint in that case petitioners recognized that if constitutional, Section 11 left them "no alternative but to dissolve". Comm. Ex. 69 (Vol. 1, p. 177). Their own "plans", which loom so large in the present argument (see Amer. Br. p. 101–107; Elec. Br. p. 27–31), recognized before the entry of the Commission orders the necessity for substituting a single class of stock for their existing complex stock structures[20] and, although the plans are somewhat vague on this point, for substantially

[20] The petitioners recognized the impossibility of continuing with their present structures in their statements concerning their Section 11 (e) plans. American's plan states (R. 415):

"It is not the purpose here to raise any technical or disputed questions as to the legal interpretation of these statutory provisions [Sections 11 (b) (1) and 11 (b) (2)]. They have not yet been authoritatively construed by the courts, and the Commission itself has not definitely exhausted the field of interpretation. The Commission has instituted against American Company proceedings under both Sections 11 (b) (1) and 11 (b) (2), upon charges that the present system violates these requirements of the Act. *Without weighing these charges, it is obvious that American Company will be required to readjust its capital structure, and divest itself of control of a number of its important subsidiaries.*" [Italics added.]

Electric's plan states (R. 496):

"*In order to comply with Section 11 (b) (2) of the Act*, it is proposed that the existing classes of capital stock of Electric (including the $7 Preferred Stock, the $6 Preferred Stock, and Second Preferred Stock, Series A ($7), including arrearages, and the Common Stock) be replaced by a single class of stock * * *." [Italics added.]

eliminating their debt. They recognized, in addition, that Section 11 (b) (1) would require disposition of many of their scattered operating companies in order to limit them to a single integrated system and retainable additional systems. After the instant orders were entered petitioners advised their security holders that they did not intend to appeal in view of the necessity for reorganization, regardless of the orders.

The main thrust of petitioners' argument is that the remedy which the Commission adopted was too harsh. They argue strenuously that the Commission was under an obligation to bring about a transformation which would leave them with appropriate capitalizations and holdings, and with a management of their own free of Bond and Share control, rather than adopt what they term the drastic remedy of dissolution. We shall show below that apart from metaphor their argument rests on nothing more than a distinction between (1) continuing with the existing Maine corporations and (2) utilizing newly organized corporations with appropriate domicile and capital structures as vehicles for maintaining common control over any combinations of operating companies which need a parent holding company to tie them together as an integrated system.[21] In fact, the real difference

[21] Both petitioners' plans recognized the possibility of using newly incorporated holding companies rather than the existing entities to hold control over permissible combina-

between what is required by the Commission's order and petitioner's own proposals is that the Commission by entering its orders required action, whereas petitioners were seeking to defer any requirement for action pending further hearings and discussions predicated upon only a vague promise of subsequent voluntary amendments by which their plans might become concrete. We shall show below in Point II that the circumstances presented by the record compelled the action which the Commission took.

Since these determinations by the Commission were made in the light of its findings concerning complexity and inequitable distribution of voting power, and since petitioners do in some respects challenge those conclusions, we believe it advisable to examine first the basis for the Commission's finding that petitioners in fact violated the statutory standards.

A. *The corporate structures and continued existence of American and Electric unfairly and inequitably distribute voting power in the Bond and Share system*

In reaching its determination that Bond and Share's voting control of the subsidiary operating companies rests on inequitable distribution of vot-

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tions of operating companies (R. 400–401, 432, par. 59; 503 fourth paragraph). Even the relatively minor expense of a new charter may be avoided in the event of a change of circumstances pointing to an appropriate use for the existing corporate entities.

ing power, the Commission had as a guide the Congressional declaration in Section 1 (b) of the Act that the national public interest and the interests of investors and consumers are adversely affected "*when control of such companies is exerted through disproportionately small investment.*"[22] [Italics supplied.] The facts set forth in the Commission's opinion clearly demonstrate that the investment through which control[23] is exercised at various levels in the Bond and Share holding company system is "disproportionately small" to that of the public investors in petitioners and in their subsidiaries, and "disproportionately small" to the properties controlled. The facts also show that the existence and corporate structures of petitioners were important factors in making possible this disproportion between the investment representing control and the aggregate of properties controlled. These facts are summarized below with respect to each petitioner.

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[22] Other evils described in Section 1 (b) which are singularly exemplified by Bond and Share's creation and use of petitioners are those which occur "when such securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties and upon the basis of paper profits from intercompany transactions, or in anticipation of excessive revenues from subsidiary public-utility companies" (see *infra*, pp. 73–75).

[23] We have pointed out in note 8, p. 6, *supra*, that there is no question that control by Bond and Share over the petitioners and control by petitioners over their subsidiaries is complete. For a graphic portrayal of the channels through which Bond and Share controls its system, see Appendix D, *infra*.

American

In round numbers, American has an aggregate capitalization of $270,000,000 (at December 31, 1941). This consists of $46,000,000 of debentures, $177,000,000 of preferred stock, and $47,000,000 common stock and surplus. Since the arrearages of preferred stocks amount to $35,000,000, adjustment for these arrearages leaves a net equity for the common stock of only $12,000,000. On this basis the debentures and preferred stocks represent over 95% of the capitalization, whereas the common stock represents less than 5%.[24] Nevertheless, the common stock has over 62% of the voting power; and Bond and Share, through its ownership of 31% of American's common and 3% of its preferred, holds 20.7% of the total voting

[24] The following table sets forth the capital and surplus of American and the voting power of its securities by classes at December 31, 1941 (R. 537, 631):

	Stated value	Stated value adjusted for dividend arrearages		Votes per class	
		Amount	Percent of total	Number	Percent of total
Debentures	$45,849,000	$45,849,000	16.9	None	
$6 preferred stock	79,300,926	79,300,926	35.7	793,581	16.6
Dividend arrearages		17,319,338			
$5 preferred stock	97,844,400	97,844,400	42.8	978,444	20.5
Dividend arrearages		17,795,450			
Common stock	37,434,351	12,384,497	4.6	3,008,511	62.9
Capital surplus	36,026				
Earned surplus	10,028,908				
Total	270,493,611	270,493,611	100.0	4,780,536	100.0

power (R. 537–538, 614), which, as above noted, has proved sufficient for complete domination.[25]

Bond and Share's holdings in American have a total book value (including surplus and after adjustment for arrearages on preferred stocks) of $9,966,795, which amounts to 3.68% of American's total capitalization of $270,493,611. American in turn through its holdings, principally in the common stock of subsidiaries, has an interest amounting to approximately 41.67% of the total capital and surplus of the subsidiaries per books (R. 663). The total capitalization of the 21 subsidiaries of American equals $729,143,155 (R. 619).

Thus, Bond and Share, through the ownership of securities of American having a book value of less than $10,000,000, equal to 3.68% of American's capitalization (R. 663), controls not only American with its capitalization of $270,000,000, but also all the subsidiaries of American, having an aggregate capitalization of $729,000,000 (R. 619).[26] Bond and Share's $10,000,000 represents only 1.34% of the total. In other words, these figures establish a ratio of one dollar of Bond and Share investment to twenty-seven dollars of total investment at the

[25] For the six-year period 1935–41 the votes cast by Bond and Share through these securities averaged 37% of all votes cast at all stockholders' meetings (R. 617), and control by Bond and Share was specifically admitted by American's President (R. 279). See note 8, *supra*.

[26] The consolidated assets of American and its subsidiaries at December 31, 1941, were carried at $851,251,525 (R. 540).

subholding company level of the pyramid which fans out to a ratio of 1 to 73 at the base. Thereby $10,000,000 controls $729,000,000.

The Commission made alternative computations which gave petitioners the benefit of a more favorable assumption—it adjusted upward the book figures for the common stock interest in American to reflect the amount by which the values on the books of the subsidiaries exceeded corresponding values at which American carried its stock interest in those subsidiaries. Even after such adjustment Bond and Share would own only 8.2% of the capitalization of American (R. 663). Since, as we have seen, American controls its subsidiaries through an investment of approximately 42%, Bond and Share, through its control of American, controls all of American's subsidiaries by means of an investment which with these upward adjustments is only 3.42% (42% x 8.2%) of the book values of American's subsidiaries.

Electric

In round numbers Electric's aggregate capitalization (as at December 31, 1941) is $192,000,000. This consists of $30,000,000 of debentures, $85,000,000 of preferred stock and $77,000,000 of common stock and surplus. Since the arrearages of preferred stock amount to $50,000,000, adjustment for these arrearages leaves a net equity for the common stock of only $27,000,000. On this

basis the debentures and preferred stocks represent over 85% of the capitalization, whereas the common stock represents less than 15%.[27] Nevertheless the common stock has over 80% of the voting power; and Bond and Share, through its ownership of 57.3% of Electric's common stock[28] holds 46.8% of the total voting power of all Electric's securities (R. 544), which has proved sufficient for complete domination of Electric.[29]

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[27] The following table sets forth the capitalization and surplus of Electric and the voting power of its securities by classes as at December 31, 1941 (543–544, 631):

	Stated value*	Stated value adjusted for dividend arrearages		Votes per class	
		Amount	Percent of total	Number	Percent of total
Debentures	$30,380,000	$30,380,000	15.8	None	
$7 preferred stock	51,416,200	51,416,200	43.4	514,162	12.2
Dividend arrearages		32,092,278			
$6 preferred stock	25,543,067	25,543,067	20.4	255,430	6.0
Dividend arrearages		13,665,308			
$7 second preferred stock	7,518,900	7,518,900	6.6	None	
Dividend arrearages		5,131,649			
Common stock	70,462,863	26,442,376	13.8	3,452,287	81.8
Earned surplus	6,868,838				
Total	192,189,868	192,189,868	100.0	4,221,879	100.0

*The various classes of stock are not segregated as to amounts in the capital stock account of the company. The preferred stock is here assigned its liquidating value of $100 per share (except for arrears) and the balance of the capital stock account is assigned to the common stock. Reacquired shares are eliminated.

[28] In addition, Bond and Share owns an insignificant amount (485 shares) of Electric's 7% preferred stock and 13,905 shares of the nonvoting second preferred stock (R. 544).

[29] For the six-year period 1935–1941 the votes cast by Bond and Share at all stockholders' meetings through these securities averaged 75% of all votes cast (R. 617). See note 8, *supra*.

Bond and Share's direct holdings in Electric represent a total book equity (including surplus and after adjustment for arrearages on preferred stocks) of $17,558,108, which amounts to 9.14% of Electric's total capitalization of $192,189,868 (R. 544). Electric in turn, through its holdings, principally in the common stock of subsidiaries, has an interest amounting to approximately 39.21% of the total capital and surplus of the subsidiaries. The total capitalization of the 11 direct and 11 indirect subsidiaries of Electric equals $654,000,000. (R. 622.) Thus, Bond and Share, through the ownership of securities having a book value of slightly over $17,500,000 equal to 9.14% of Electric's capitalization, controls not only Electric with its capital of $192,000,000 but also all the subsidiaries of Electric having an aggregate capitalization of $654,000,000 (the consolidated capitalization of Electric and its subsidiaries is $749,183,549, R. 547, n. 20). Bond and Share's $17,500,000 interest equals only 2.6% of the total. In other words, these figures establish a ratio of 1 to 11 at the subholding Company level of the pyramid which fans out to a ratio of 1 to 37 at the base. Thereby $17,500,000 controls $654,000,000.

The Commission's alternative computations, as in the case of American, gave Electric the basis of a more favorable assumption which adjusted upward the book figures for the common stock in-

terest in Electric to reflect the amount by which the values on the books of the subsidiaries exceeded corresponding values at which Electric carried its stock interest in those subsidiaries. Even after such adjustment Bond and Share would own only 22.25% of the total capitalization of Electric. Since, as we have seen, Electric controls its subsidiaries through an investment of 39%, Bond and Share through its control of Electric controls all of Electric's subsidiaries by means of an investment which, with these upward adjustments, is only 8.72% (39% x 22.25%) of the book value of Electric's subsidiaries. (R. 666.)

These facts alone are sufficient justification for the Commission's conclusion that the existence and corporate structure of American and Electric unfairly and inequitably distribute voting power in the Bond and Share system and its opinion so states (R. 621–622, 624).

Write-Ups and Depreciation

In fact, however, the picture is even worse. Although the book figures of the system demonstrated plainly that the distribution of voting power was not consistent with the requirements of the statute, the record made it abundantly clear that the book figures themselves were seriously overstated because they reflected unconscionable

write-ups [30] and inadequate depreciation.[31] These facts being before the Commission, it could hardly ignore their existence and seemingly endorse the accuracy of the book figures by overlooking the obvious defects which the evidence brought out.

Petitioners attempt to argue that the Commission's opinion is based solely on the computations

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[30] The Commission found that the practice of inflating the accounts of the Bond and Share system companies was not occasional or sporadic, but was almost routine. The Commission stated (R. 601–603):

"We have already described the financial pattern employed by the subholding companies (under Bond and Share's aegis) in setting up those operating companies which represented an amalgam of smaller units. Through systematically writing up the property accounts of the reorganized operating companies and causing them to issue to the subholding companies securities in amounts greatly exceeding the latter's cost, the subholding companies were enabled to recover all costs incurred in the process of combination as well as the greater portion, if not all, of their initial cost of acquiring control. The record presents this pattern stamped with a most monotonous regularity on each of the subsidiaries organized by American and Electric, as we previously found to be the case in National. We do not believe it is necessary to cumulate the details of each instance; a glance at Appendices E–2 [R. 665] and F–2 [R. 667] of this Findings and Opinion demonstrates that each of the subsidiaries formed by either subholding company bears on it the deformities resulting from this type of birth, in the form of inflated plant accounts and overcapitalized structures."

[31] The Commission found that this inadequacy was attributable largely "to the insistent demands of their holding company parents for payment of the largest possible amount of dividends" (R. 603, n. 107).

made after adjustment for write-ups and depreciation. They place emphasis on the use by the Commission of reference to the "foregoing figures" (Am. Br., pp. 92, 93; Elec. Br., pp. 39–43). However, examination of the opinion (R. 619–624) shows that the Commission's findings are the result of examination of numerous sets of figures rather than any single group and that the greatest emphasis is placed on the figures *before* adjustment for write-ups and depreciation. Indeed those are the figures mentioned immediately before the Commission's conclusion that "on the basis of the foregoing figures," voting power was unfairly and inequitably distributed (R. 621–623, 624).

When adjustment is made solely for the apparent write-ups in their subsidiaries, American's share in the capitalization of its subsidiaries shrinks from 41.7% to 21.4% and Electric's shrinks from 39.2% to 32.7% (R. 663, 667).[32] Bond and Share's interests in American and Electric are in turn correspondingly reduced. Consequently Bond and Share's interests in the operating subsidiaries through its ownership of American and Electric's securities become much more attenuated than is indicated by the figures of 3.42% and 8.72% based on the books without adjustment. If

[32] Since proceedings were pending before the Commission with respect to United Gas Corporation, figures on write-ups in that subsidiary of Electric were not included in the Commission's computation (R. 623, n. 136).

the depreciation reserves of the subsidiaries are further adjusted to bring such reserves into accord with depreciation claimed or allowed for federal income tax purposes, the interests of American and Electric in the adjusted capitalization of their respective subsidiaries and the interests of Bond and Share in American and Electric are all substantially reduced again. Thereby the disproportion between investment and control by Bond and Share over the subsidiaries of the subholding companies is further accentuated.

Appendices E–2 and F–2 to the Commission's findings (R. 665, 667) show in the case of the American and Electric systems, respectively, the book assets and capitalization of each subsidiary with adjustment for indicated system write-ups and a separate adjustment which shows the effect which would be realized by utilizing depreciation claimed for income tax purposes in lieu of that shown on the books. In view of petitioners' present challenge both to the relevance and reliability of these figures it is important to note the use made of them by the Commission. While, as we noted above, inequitable distribution of voting power and undue complexity existed on the basis of book figures alone, it was a matter of aggravation that the book figures were grossly in excess of actual investment. Moreover, as we note below, it was relevant to the choice of remedy that many of petitioners' subsidiaries would probably have to be

recapitalized for business reasons as well as to meet requirements of the Act. The problems before the Commission, however, did not then require a complete and definitive revision of the accounts of each subsidiary or a depreciation study of the properties of each subsidiary, either of which would have prolonged the hearing out of all proportion to any further light that would have been shed upon the issues in the instant case.

With respect to the relevance of depreciation claimed for income tax purposes, the Commission noted that for the subsidiaries of American the aggregate difference between book reserves and that claimed for tax purposes was $94,800,000 (amounting to over 10% of total book assets), but added that "concededly this is not to be deemed a conclusive figure." The Commission also referred to published studies of the Public Utilities Division comparing depreciation policies on an industry-wide basis from which it appeared that out of the entire group of 30 holding company systems included in the study "book accruals for depreciation were smallest relative to depreciation for tax purposes in the case of the subsidiaries of American." (R. 620, n. 132.) It also noted instances where depreciation accruals were materially reduced after acquisition by American (R. 603, n. 107). In the case of Electric the Commission noted that the aggregate difference between depreciation per books and depreciation for income tax purposes is approxi-

mately $121,000,000, again adding that this was not deemed a conclusive figure and that approximately $80,000,000 of the amount is applicable to United Gas Corporation "as to which special tax provisions regarding gas production properties may make somewhat less appropriate the comparison between book figures and tax figures" (R. 623, n. 137).[33]

American offers a post-record challenge to the validity of these figures based on the fact that in subsequent proceedings with respect to certain of these subsidiaries the Commission failed to compel adjustments in book provisions for depreciation to bring book depreciation reserves up to the income tax figures (Amer. Br., footnote p. 92).[34]

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[33] Under the tax laws straight-line depreciation is used. This is an accepted method of accounting for depreciation in the utility field. See *Telephone and Railroad Depreciation Charges*, 118 I. C. C. 295–411 (1926), and 177 I. C. C. 351–500 (1931). The "retirement" method which petitioners' subsidiaries have followed through most of their history was abandoned by the National Association of Railroad and Utilities Commissioners in 1938. See *Uniform System of Accounts for Electric Companies* prescribed by Federal Power Commission, General Instructions No. 10 and Definition No. 13; Securities and Exchange Commission Rule U-27; *Public Utility Regulation*, Mosher and Crawford (1933), p. 155, and *Public Utility Economics*, Thompson and Smith (1941), pp. 335–36.

[34] We deal below with Electric's claim that the facts regarding it were misstated by the Commission's opinion (see *infra*, pp. 55–59), and show in that connection that Electric is in reality only making the point referred to in the text, although this may not be apparent upon first reading of the discussion at pages 39 to 42 of its brief.

In none of the proceedings referred to did the Commission purport to approve the adequacy of the reserve for depreciation as stated after giving effect to the transactions under consideration.[35] Moreover, the Commission has taken the position with respect to depreciation, generally, that it favors application in the future of straight-line depreciation related to estimated useful life of the properties involved, but because of the practical obstacles involved it does not favor a general requirement which would compel readjustment of existing depreciation reserves to the amount which would be indicated by applying such computations to prior years.[36] Thus, while the Commission did not purport to make a depreciation

[35] In the only one of the cases cited by American which specifically mentions adequacy of the resulting reserve the Commission said:

"While the record in this case indicates that a reserve of this size probably does not reflect the actual depreciation sustained on Florida's property, considering all the circumstances of the case, including present and stated probable future policy of the company with respect to depreciation appropriations from income, the estimated amounts of property to be constructed and retired during the next several years, and the resultant anticipated substantial increase in the reserve, we can accept the present reserve as adjusted as not so unreasonable as to require further action on our part." *Florida Power & Light Company*, — S. E. C. — (1943), Holding Company Act Release No. 4791, at p. 20.

[36] See Statement of Ganson Purcell, Chairman, Securities and Exchange Commission, before the Committee on Depreciation of the National Association of Railroad and Utilities Commissioners (Chicago, Ill., March 8, 1944), printed as Appendix E to this brief. Alleged unfairness of retroactive application of straight-line depreciation for rate making

study of petitioners' subsidiaries, we believe it was entitled to attach some relevance for purposes of analysis to the income tax figures, particularly where the discrepancies were relatively high as compared to the rest of the industry. Inadequacy of depreciation reserves was in any event only a cumulative point in view of the conclusions drawn from book figures alone—and the indications of the substantial write-ups.[37]

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purposes has been of major concern to the electric and gas industry. See a review by Ralph J. Baker of *Financial Accounting* by George O. May, 58 Harv. L. Rev. 886, 893. Whatever the outcome of this dispute in relation to permissible rates, investment analysis cannot overlook deficiencies in past depreciation accruals.

[37] Petitioners quarrel with the theory on which the Commission computed net investment in all their subsidiaries, deducting minus figures shown for particular subsidiaries (Amer. Br. p. 94; Elec. Br. p. 42). Petitioners argue that all minus figures should have been disregarded and only the sum of the positive figures given. This point was not urged before the Commission and petitioners do not now undertake to show the extent that using their method would require revision in the Commission's computations. Reference to the tables in Appendices E–2 (R. 665) and F–2 (R. 667) shows that minus figures do not become significant until we reach column (13) which shows deductions both for indicated write-ups and to conform to tax depreciation. Thus in the case of American the aggregate investment in its subsidiaries less indicated write-ups is shown in column 8 as $115,759,914. Adding back $737,402, the only minus figure, would increase this amount by less than 1%. In the case of Electric's subsidiaries the total for column 8 of Appendix F–2 is $193,301,010. Adding back the only minus figure ($5,977,785) increases the total by about 3%. In the case of column 13 application of petitioner's method of computation would make substantial differences in the totals but would still leave both American and Electric with

In the case of write-ups the analysis which the Commission made was more complete, although again it did not purport to be sufficiently definitive to determine precisely what items would have to be charged to Account 107 in the applicable systems of accounts.[38] As appears to be conceded

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insignificant investments in proportion to the total assets of the subsidiaries. Lest the Court gain the impression, however, that there is any merit in these contentions, it may be pointed out that petitioners are confusing the process of determining system *investment*, which was the Commission's task, with the process of *equity evaluation*—which is irrelevant now, although it may be pertinent at a later time when allocations are involved. Cf. *Commonwealth and Southern Corporation* v. *S. E. C.*, 134 F. 2d 747, 754 (C. C. A., 3). In determining *investment* in the Bond and Share *system* which is owned and operated as an entity it was certainly not error to arrive at a *net* figure rather than merely adding all the plus figures. System control over the subsidiaries in which there was no investment was no less complete than in other instances.

[38] The Federal Power Commission system of accounts which was before this Court in *Northwestern Electric Company* v. *Federal Power Commission*, 321 U. S. 119, is substantially the same as that adopted by most state commissions pursuant to the recommendations of the National Association of Railroad and Utility Commissioners. The Securities and Exchange Commission has made applicable the same accounting classifications to subsidiaries of registered holding companies not otherwise subject to accounting regulation. Under this system Account No. 100.5 includes excess of cost in an arm's-length purchase over "original" cost, while Account No. 107 includes both upward revisions based on nothing more than an appraisal and upward revisions reflecting prices paid in a transaction between affiliate companies. See Kripke, *A Case Study in the Relationship of Law and Accounting: Uniform Accounts 100.5 and 107*, 57 Harv. L. Rev. 433, 436–438 (1944). The Commission made no adjustment for items classifiable

by American, petitioners made no direct effort to refute the facts brought out in the cross-examination by the Commission's staff "seeking to show 'write-ups' of capital accounts." They attempted only to show that book figures could be justified by opinion testimony as to present values, depreciation and earnings (Amer. Brief, p. 11). We discuss below, pp. 63–65, this rejected testimony which was offered at the close of the hearings. In the light of this record, involving as it did an analysis of accounting reports and transcripts of accounting entries which respondents themselves supplied

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in 100.5, although it called attention to their existence in "large amounts" (R. 621, 623). American complains of the adjustments for Account No. 107, contending that these are not, however, write-ups "as understood by accountants" (Amer. Br. footnote p. 91). Actually they are precisely what is thus understood, and as understood, condemned by all regulatory bodies. What occurred generally was a determination of the amount of securities which Bond and Share hoped to be able to sell to the public to recoup its expenses and thereafter an arbitrary statement of the value of assets in order to cover such securities. In most cases the write-ups did not even carry the pretense of being based upon any scientific attempt to evaluate either income or replacement value. (R. 559, n. 50.) For example, the original book entries of United Gas were determined upon by Bond and Share counsel acting as directors of United Gas. These figures were later written down by $130,000,000 on the basis of an appraisal, but only after public sale of United Gas securities. *United Gas Corp., et al.*, — S. E. C. — (1944), Holding Company Act Release No. 5271, at pp. 27–28. The Commission, therefore, did not use the term "write-up" carelessly or without consideration of what actually occurred, but used it to designate arbitrary and unjustifiable inflationary accounting practices.

pursuant to Commission request,[39] it is clear that the Commission was not dealing with pure "assumptions" and "guesses", as claimed in Electric's brief (pp. 39–40), when the Commission referred to "the apparent system write-up in each of these companies, as indicated in the present record" (R. 619 applicable to American, R. 623 applicable to Electric). When respondents, having been shown the findings, stipulated that they waived, among other things, further exceptions to the findings and opinion of the Commission or the filing of briefs and oral argument, the Commission was entitled to assume that respondents were not disputing the approximate accuracy of the indicated write-ups as bearing on overall system investment in the subsidiaries referred to.[40]

Nor have subsequent events, as petitioners would have the Court believe, cast any doubt upon

[39] For illustration of the kind of admissions upon which the Commission's findings of approximate write-ups are based, see R. 761–791 dealing with Florida Power & Light Company.

[40] Purely by way of illustration the Commission's findings referred to the following concrete transactions in which write-ups occurred: (a) In the American system—Kansas Gas and Electric Company, more than $2,500,000 (R. 559, n. 49); Florida Power & Light, approximately $30,000,000 (R. 605, n. 111); Texas Power & Light Company, $19,000,000 (R. 571, n. 70); (b) In the Electric system—Utah Power & Light Company, approximately $32,300,000 (R. 571, n. 70); Arkansas Power & Light Company, Louisiana Power & Light Company, and Mississippi Power & Light Company, a total of $34,700,000 (R. 585, n. 89). These separate transactions would not necessarily include all write-ups for the company in question.

the adequacy of the write-up figures for the purposes the Commission then had in hand. Petitioners' efforts to discredit Appendices E–2 and F–2 are aimed exclusively at the calculations in column 13, showing the effect on petitioners' interest in the book capitalization of their subsidiaries of deducting both the indicated write-ups and the difference between depreciation claimed for income taxes and per books. See Elec. Br. pp. 40–42, Amer. Br. pp. 95–96. Petitioners point to a number of subsequent transactions in which accounting adjustments were required or passed on by the Commission or other regulatory authorities as a result of which petitioners emerged with securities having a book value substantially in excess of what the Commission said would result from making both adjustments. Since, however, the transactions referred to did not purport to pass on the adequacy of the resulting depreciation reserves, such transactions are useful only to check the accuracy of the Commission's computations concerning the indicated write-ups. As such they fully substantiate the accuracy of the Commission's figures as indicating both that write-ups were substantial and the approximate amounts thereof.

Thus Electric compares (Br. p. 40) a subsequently achieved book equity in Idaho Power Company of $9,929,000 with the Commission figure of $5,633,794. But the latter figure, taken from Appendix F–2 column 13 (R. 667) reflects

adjustment of $3,418,300 for depreciation and $9,523,401 for indicated system write-ups (see column 6 of Appendix F–2). In fact, the write-downs in plant account subsequently made by Idaho aggregated $9,562,633, a difference of only $39,000 from the indicated write-up assumed in the opinion. Electric's purported discrepancy in figures reflects substantially the fact that the depreciation adjustments shown in the opinion were not required to be effected in the subsequent transactions. The situation is almost identical in all the other companies mentioned, and to avoid repetition we include at pages 60–61 a table showing the amounts of the indicated system write-ups set forth in the Commission's opinion and the actual write-down in plant account subsequently made by the companies in question. The table includes all subsidiaries of both Electric and American whose property accounts have been the subject of definite orders.[41] In addition, in order to show the relative significance of any variations, we

[41] The findings as to United Gas Corporation, mentioned by Electric (Elec. Br., p. 40), made no adjustment whatever for indicated write-ups since the matter was then pending before the Commission in a proceeding relating to *United Gas* (R. 587, 623 n. 136, 667 n. 6). Furthermore, the adjustment made on the basis of tax depreciation was regarded by the Commission as somewhat less relevant in the case of the gas production properties held by United than would be the case in dealing with an electric or gas plant account (R. 623). Cf. *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. 591. In the subsequent reorganization of United Gas, the Commission did not determine either

have set forth the amount which the two figures represent as a percentage of the book figures of the company before adjustment for write-ups.

Nor is it indicative of inaccuracy in the Commission's figures that some of the subsequent transactions have resulted in realization, through sales, of sums substantially in excess of book values as adjusted for indicated write-ups, to say nothing of such further adjustments as might be necessary with respect to depreciation. Where the Commission passes on the price at which such interests may be sold, it has limited its regulatory functions to insistence upon arms' length dealings and adequate disclosure to possible purchasers, and has not prevented the vendor holding companies from realizing the sums substantially in excess of book value when obtainable.[42] Sales to public authorities are exempt from Commission scrutiny under the Act and its rules, and in the case of the

what depreciation reserve would be adequate or the amount of the write-ups in the plant account. However, the new balance sheet contained a reserve plus a frozen surplus account in the aggregate amount of approximately $40,000,000 which the Commission noted would be available for such write-downs as might be required. *United Gas Corporation*, — S. E. C. — (1944), Holding Company Act Release No. 5271. The table did show the undisputed figures as to the amount of the discrepancy between book and tax depreciation reserves.

[42] For a relatively extreme instance see *Public Servic Company of Colorado*, — S. E. C. —, (1943), Holding Company Act Release No. 4699 and see the dissenting opinion in that case.

Comparison of write-ups cited in Commission opinion with write-ups subsequently ordered to be disposed of or reserved for by subsidiaries of American and Electric [1]

	(1) Amount of write-up	(2)	(3) Percent relationships to book interests shown in columns 3 of appendices E-2 and F-2 of write-ups shown in—		Source of information concerning disposition orders
	Indicated in Commission opinion	Ordered to be disposed of or reserved for	(1)	(2)	
Subsidiaries of American:					
Florida Power & Light Company	[2] $36,883,684	[2] $31,453,494	63.1	53.8	Holding Company Act Release No. 4791—File No. 70-403.
Kansas Gas and Electric Company	1,846,194	[3] 2,987,819	21.6	34.9	Federal Power Commission Release No. 2468.
Minnesota Power & Light Company	22,055,786	[4] 21,762,087	87.1	86.0	Holding Company Act Release No. 5850 File Nos. 54-101 and 59-75.
The Montana Power Company	57,000,000	[5] 46,891,597	77.1	63.4	Holding Company Act Release No. 5897—File No. 70-1094.
Nebraska Power Company	5,866,453	[6] 5,950,072	64.5	65.5	Federal Power Commission Release No. 2555.
Northern Power Company	273,067		37.0		Holding Company Act Release No. 4220—File No. 70-675.
Northwestern Electric Company	3,500,000	3,500,000	47.5	47.5	Federal Power Commission Order 12/6/40—Docket IT-5642—Aff'd. 321 U. S. 119.
Pacific Power & Light Company	4,164,728	[7] 4,609,674	36.0	39.9	Federal Power Commission Orders 10/27/42 and 11/24/42.
Superior Water Light and Power Company	1,255,626	1,000,000	33.5	26.7	Holding Company Act Release No. 4220—File No. 70-675.
Texas Electric Service Company	33,014,107	[8] 34,399,786	102.3	106.6	Holding Company Act Release No. 5472—File No. 70-1041.
Texas Power & Light Company	19,000,000	[9] 20,482,307	65.8	70.9	Holding Company Act Release No. 5798—File Nos. 70-1069 and 70-1070.
The Washington Water Power Company	2,117,765	[10] 3,633,338	6.9	11.8	Federal Power Commission Release No. 2517.
Total Subsidiaries of American	186,977,410	176,650,174	64.3	60.7	
Subsidiaries of Electric:					
*Arkansas Power & Light Company	3,875,244	[11] 3,614,559	25.4	23.7	Holding Company Act Release No. 5294—File No. 70-953.
Idaho Power Company	9,523,401	9,562,633	51.4	51.6	Holding Company Act Release No. 4494—File Nos. 70-752 and 70-753.
*Louisiana Power & Light Company	9,632,602	[12] 7,637,203	85.5	67.8	Holding Company Act Release No. 4977—File No. 70-785.
*Mississippi Power & Light Company	6,753,234	[13] 9,212,172	70.7	96.7	Holding Company Act Release No. 4888—File No. 70-843.
New Orleans Public Service Company, Inc.	452,010	[14] 8,827,065	2.2	42.2	Registration Statement—File No. 2-5411, footnote 1 to balance sheet.
Utah Power & Light Company	31,954,713	[15] 33,563,981	123.0	129.2	Federal Power Commission Release No. 2500.
Total Subsidiaries of Electric	62,170,604	72,417,613	61.3	71.4	
Cumulative Total Subsidiaries of American and Electric.	249,148,014	249,067,787	63.5	63.5	

[1] Included in this comparison are only those subsidiaries whose property accounts have been reviewed by regulatory bodies having jurisdiction and concerning which accounts definitive orders have been issued.

[2] Subsequent to organization of Florida but prior to recapitalization as at Oct. 31, 1943, $4,270,135 of additional write-ups were eliminated.

[3] Exclusive of additional amounts of $287,507 whose disposition is being held in suspense and $184,039 previously eliminated.

[4] Exclusive of an undetermined amount to be classified subsequently and representing intrasystem profits on fees paid to affiliates in the gross amount of $1,306,148.

[5] Elimination of this amount was required by a Federal Power Commission order which is in litigation, but $28,600,000 has been eliminated as required by Montana Public Service Commission and Montana has created a reserve in excess of the balance in litigation.

[6] Proposed by company in filing submitted to Federal Power Commission. Exclusive of capitalized intrasystem profits on fees paid to affiliates estimated not to exceed $900,000.

[7] Exclusive of additional amounts to be classified subsequently and representing capitalized intrasystem profits on fees paid to affiliates.

[8] As at Dec. 31, 1941. Of this amount $2,225,236 was eliminated prior to Dec. 31, 1944, at which time the balance of $32,174,550 was reserved for or eliminated.

[9] As at Dec. 31, 1941. Of this amount $1,360,000 was eliminated prior to Feb. 28, 1945, at which time the balance of $19,122,307 was reserved for or eliminated.

[10] Exclusive of additional items aggregating $85,250 held in suspense.

[11] As determined by the Department of Public Utilities of Arkansas. The report of the staff of the Federal Power Commission which has not been passed upon by that Commission indicates that the staff is of the opinion that there are additional write-ups in the accounts of Arkansas of approximately $2,468,000.

[12] Exclusive of profits on fees in the amount of $195,779 paid to affiliates.

[13] Exclusive of profits on fees in the amount of $185,425 paid to affiliates.

[14] Represents charges to earned surplus and property retirement reserve during 1942 and 1943 pursuant to orders of the Public Utilities Commissioner of the city of New Orleans.

[15] Includes write-downs made by Utah's wholly owned subsidiaries. The amount is exclusive of capitalized profits on fees paid to affiliates in the amount of $1,032,327 and a claimed credit of $484,039.

* Since Arkansas, Louisiana, and Mississippi were acquired by Electric in a basket transaction, the determination of the amount of write-ups included in the plant accounts of the individual companies involved a problem of allocating the purchase price among the three companies. As will be noted, the total determinations of the Commission and the Federal Power Commission with respect to the three companies were in almost complete agreement, differing by only about $224,000, although by individual companies there were more substantial differences by reason of different bases of allocation.

Nebraska transaction referred to by American (Br. pp. 95–96), the Commission did not pass on the price paid.[42]

The slim investment of American and Electric in the operating companies and the much more attenuated investment of Bond and Share was not a matter of accident, it was a matter of design. It was due in part to the very scheme of setting up the sub-holding companies in order to provide a vehicle for recouping Bond and Share's investment through the sale of bonds and preferred stocks after writing up the value of the assets of the operating companies. It is due further to the fact that when additional financing for expansion or improvements occurred it was effected through the sale of senior securities of the operating companies and the subholding companies in order not to impair Bond and Share's voting control and to retain and increase its leverage position. And when voting control became lessened through increases in outstanding preferred stock Bond and Share, through petitioners, engineered split-ups in the common stock so as to increase its percentage of voting power without the contribution of additional capital."[43]

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[42] That transaction is currently the subject of inquiry by a subcommittee of the House Committee on Interstate and Foreign Commerce.

[43] The record discloses that, in numerous instances when Bond and Share or the petitioners were dissatisfied with the adequacy of the voting power vested in the common stock of

The proffered valuation evidence

American complains that in making its determination the Commission refused to consider certain "valuation evidence" offered by it (Amer. Br. 97–101), but as we have shown above the undisputed evidence of violation of the statutory standards in terms of the company's own representations to the public and to the Commission was so overwhelming that no conceivable valuation testimony could affect the Commission's conclusions that the subholding companies are extreme leverage and pyramiding devices and must be eliminated to insure a fair and equitable distribution of voting power as well as to remedy undue complexity.[45] The Commission had before it a full record of earnings of petitioners and their subsidiaries, including dividend arrears, which showed that book investment was certainly not low in relation to proven earning power. More-

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a controlled company, they effected a split-up in such a manner as to multiply the voting strength of the common while decreasing the voting power of the publicly held preferred stock proportionately (R. 565, n. 62). The proposed split-up would be submitted for formal vote of the security holders, but no indication would be afforded to the security holders of the result of the action on relative voting power, although in some instances its immediate effect would be to strip voting control of a corporation from its preferred stockholders and vest it in the common stockholder, in each case the holding company. (R. 564–565.)

[45] For example, no amount of valuation testimony could explain away the vast accumulation of the arrearages on preferred stocks of both petitioners.

over, even if we accept the maximum value for American that Bond and Share offered to prove, the result would be that, instead of Bond and Share's control being exercised through ownership of 3.42% of the book value which formed the basis of the Commission's findings, such control would be exercised through ownership of 3.83% of the present value of the system.[46]

Valuation testimony would be relevant only in connection with Plans for compliance with the Commission's order, when the action to be taken has already been determined and the sole problem is the proper allocation of securities in a system simplified in accordance with the order. American's counsel recognized this fact and stated that the evidence was "directed to the Plan" (R. 256). Since the Plan was properly excluded from consideration in connection with the present issues, see pp. 136–140, *infra*, the valuation

[46] The offer of proof (R. 240–253) was to the effect that American's interest in its subsidiaries would be established at a value of $315,500,000 (R. 251). Substituting this amount in Appendix E–1 (R. 663) for the $303,837,930 shown therein as the underlying book value of American's investments in its subsidiaries as of December 31, 1941, Bond and Share's interest in the total capitalization of American would be $28,395,213. The result is that through an investment in the amount of $28,395,213 Bond and Share controls American's subsidiaries whose properties have a "value" of $741,854,644 (R. 248). Control would thus be exercised through 3.83%, as compared with the percentage of 3.42% upon which the Commission's findings are based. Cf. the percentages in Electric, *supra*, pp. 45–46.

testimony fell with it. The timing of the offer [47] and the nature of the testimony offered [48] clearly indicate the purpose of the offer was merely to delay the entry of an order.

The bases of the Commission's computations in determining inequitable distribution of voting power

Petitioners criticize the Commission's analysis of voting power. They argue that it involves the fallacy of assuming that debt securities and preferred stock should have a vote, and that it involves a comparison of Bond and Share's and petitioners' holdings in subsidiary capitalization "which consist primarily of voting securities * * * with total consolidated capitalization, including debt and non-voting preferred stocks, without any reference to position or function of the securities in the system." (Amer. Br. p. 89, and see Elec. Br. p. 39). It is then urged that this position is inconsistent with the Commission's disposition of financial applications in

[47] It was not until after two years of hearings and when steps were being taken to conclude the proceedings that American made a formal offer of its valuation evidence as part of the steps taken to conclude the hearings.

[48] The testimony offered consisted in part of "reproduction cost new" estimates by one of Bond and Share's managers (R. 241). For the relation of such testimony to present values, see *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U. S. 575. Cf. *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U. S. 591.

which the Commission has permitted the issuance of bonds and preferred stock having no normal voting rights but merely contingent provision for controlling voting rights in the event of arrearages on preferred stocks. Petitioners neglect to point out that the Commission's approach to the problem of bringing about equitable distribution of voting power, whether in new financing or in reorganizations, has been primarily to insist that the control of the enterprise be exercised through the medium of common stocks which represent a genuine "cushion" of junior investment, rather than to endow with voting control bonds or preferred stocks in amounts disproportionate to assets and earning power.[49]

Of course, this does not mean, nor did the Com-

[49] See *Jacksonville Gas Company*, 11 S. E. C. 449, 457, wherein the Commission approved a plan providing for reduction of operating company debt and issuance of new common stock to creditors in order to correct inequitable distribution of voting power in an operating company. With respect to other possible methods of correcting inequitable distribution of voting power, the Commission said:

"For example, the suggested alternative of shifting voting control to the senior security holders, but leaving the existing capitalization unchanged, would leave outstanding a common stock with neither value nor voting power—a security which could serve no purpose other than to ensnare uninformed and unsuspecting investors. For another thing, such a capital structure would render almost impossible any sound financing by the company. It would do only part of a job that Section 11 is designed to do and would be inconsistent with the objectives of the Act."

The Commission also referred to the declared policy of

mission determine, that the percentage of voting power and the percentage of investment should be equal. As the Commission stated in its findings with respect to National Power and Light Company, *Electric Bond and Share Company, et al.*, 9 S. E. C. 978, 992:

> In making the above series of computations and comparisons, we are not unmindful of the fact that a comparison solely of the capital invested by each class of security holder is not conclusive on the issue of the fairness and equity of voting power distribution without possible weighting for differences in the risk position of the respective classes of security holders or other factors. However, there is no process of weighting that could render fair and equitable a distribution of voting power which vests complete control of the system in securities which represent at best 6.65 percent of the capitalization (without any adjustment for known write-ups or deficient retirement reserves) and in effect disfranchises those who contributed 93.35 percent

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the Act to eliminate evils which include "securities • • • issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties;" and added:

"A mere shift in voting power, leaving the corporate structure of the Jacksonville company unchanged, would be clearly repugnant to those policies.

"A mere transfer of voting power would also be unsatisfactory from other points of view. It would be unsound from the point of view of managerial policy to have voting control vested in securities having a limited return; in a

of the system's capital. Accordingly, we find that voting power is unfairly and inequitably distributed among the security holders of the National-Bond and Share System, within the meaning of Section 11 (b) (2) of the Act.

This is in no way inconsistent with the Commission's exclusion of Bond and Share's direct holdings of securities in certain of the operating companies in determining its investment in control. These securities are no part of the investment through which Bond and Share's control over the operating companies "is exerted" (see Section 1 (b) (3) of the Act), since, as we have seen, such control stems from its control over the petitioners. Whether or not Bond and Share owned these securities would not affect its con-

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case where the common stock had some small equity in the enterprise, the difficulty of protecting its interest under such circumstances would be obvious. Transferring to the bondholders the presently outstanding common stock carrying the voting power (even if it could be done under the statute) would not be a solution as there would be no assurance that the bondholders would retain the stock, and as soon as it was transferred, the problem would again be as it is found today."

See *In re Jacksonville Gas Company*, 46 F. Supp. 852, 857 (S. D. Fla), approving and enforcing the same plan. See also *Massachusetts Mutual Life Ins. Co.* v. *S. E. C. and Laclede Gas Light Co.* (C. C. A. 8), decided October 30, 1945, wherein the Court said: "The findings that the indebtedness of Laclede Gas is excessive, and that the distribution of voting power among its security holders is inequitable are not controverted. The first of these conditions is obviously the cause of the second."

trol over the system.[50] Nor do these holdings have any bearing on the extent of the unfairness of the voting power caused by the corporate structures and existence of petitioners.

B. *American and Electric Unnecessarily and Unduly Complicate the Structure of the Bond and Share System*

1. Petitioners cause major complexities in the Bond and Share system

Section 11 (b) (2) makes it the duty of the Commission to require the taking of such steps as it shall find necessary "to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly *or* unnecessarily complicate the structure, * * * of such holding-company system." [Italics supplied.] The Commission's

[50] Indeed, the Commission might well have excluded all system holdings of non-voting securities, which would have further reduced the percentages. These included 13,905 shares of Electric's non-voting second preferred stock owned by Bond and Share (R. 544), and substantial holdings of various debt securities of its subsidiaries by American, e. g. $22,000,000 of Florida Power & Light Company 6% gold debentures, and $10,589,000 of Montana Power Company's 5% debentures (R. 659).

With one exception, the operating company holdings in Bond and Share's portfolio consist only of debt securities. Bond and Share's holdings of United Gas Corporation, a subsidiary of Electric, alone include voting securities, but only in a relatively minor amount (R. 613). These non-voting securities are not the securities by which Bond and Share controls the system. Moreover, there is an inherent unfairness in the combination of control through a junior

finding rests severally on the facts that petitioners "unduly" as well as "unnecessarily" complicate the structure of the Bond and Share system (R. 634). We show below (pp. 80–93) the basis for the Commission's finding that such complication as is caused by petitioners' existence is wholly unnecessary because they perform no useful function. Absent a useful economic function it is self evident that petitioners' continued existence is an unnecessary complication since even if they had the simplest capital structures and were not used as leverage devices in the Bond and Share system, the mere interposition of subholding companies incorporated in Maine between Bond and Share, a New York corporation, and the operating subsidiaries located in states other than New York and Maine is unquestionably a complication.

With respect to the undue character of this complication the Commission's finding rests upon the circumstance that the function of the petitioners in the Bond and Share system—that of leverage and pyramiding devices—typified the evils which Section 11 was intended to eliminate. As shown

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equity security with a debt claim ahead of public holdings in preferred stocks. One of the most unfortunate situations in which a public investor in senior securities of a subholding company may find himself is that which exists when the parent holding company which owns the control securities junior to his investment also has a prior ranking debt claim against the underlying subsidiary, thus threatening to grind the public investor as between the upper and nether millstone. See, for example, *In re Commonwealth Light and Power Company*, 141 F. 2d 734 (C. C. A. 7).

by Section 1 (b) (3), those evils included among other things, the control of operating companies "exerted through disproportionately small investment." [51] It was largely through the use of petitioners as leverage and pyramiding devices that Bond and Share was enabled to amass control over billions of dollars contributed by others and to realize for itself huge earnings and profits without

[51] Petitioners complain that Congress did not use the words "pyramiding" and "leverage" in the Act. These concepts were, however, unquestionably part of the legislative background and recognized as among the major evils against which the Act was directed. With respect to pyramiding and leverage, The Federal Trade Commission stated:

"A relatively small investment in common stock in the higher levels of a pyramided structure may represent absolute control of underlying operating companies with assets of hundreds of millions of dollars. The fact that public utilities are normally financed to a larger extent than industrials by the sale of bonds and preferred stock with comparatively low fixed returns and generally with no voice in the management, so long as interest is not in default nor preferred dividends in arrears, is the fundamental basis of the pyramid. It results in absolute operating control by a relatively small investment in common stocks and a very high rate of return on the common stock, provided the operating companies are prosperous, but a low, or no, return on such common stock when the business of the operating companies shrinks.

* * * * *

"This form of structure has two startling results. The investment representing management control is reduced to a dangerous minimum, and this extremely thin equity becomes the recipient of any residual earnings over and above the fixed dividends and interest requirements of senior securities. * * * in the electric public-utility industry the tendency has been to regard about 7 or 8 percent as a reasonable rate

investment."[52] Congress, and all the responsible agencies whose findings Congress adopted, found that these functions are deleterious to the national

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of return for operating companies. If the rate base on which the return is computed is equal to the book investment of the operating company an 8 percent return is adequate to pay normal interest and preferred-dividend rates for the operating company (with 50 percent in bonds and 25 percent in preferred stock) and leave residual earnings for the common stock which, if passed up through a holding-company pyramid of only two holding companies, in which the common stock is in each case 50 percent of the total capitalization, represent an extraordinarily high rate of return on the common-stock equity representing ultimate control.

"Any reduction below 7 percent for the operating companies, however, encroaches rapidly on the common stock equity earnings; and a decrease, say, to 5 percent, would dry up all earnings for the higher layers of the pyramided structure, so far as those companies depended solely on operating company dividends for income. Whichever is the result, the consequences are unfavorable to investors, on the one hand stimulating a dangerous speculative interest and on the other hand bringing financial loss, and maybe ruin, to many shareholders who regarded the securities of the top holding company as a sound investment.

"None of the large holding-company groups appears to have had a suitable capital structure from an investor's standpoint." (*Utility Corporations*, S. Doc. No. 92, 70th Cong. 1st Sess. (1935), Part 72–A, pp. 858–859.) See also Committee on Interstate and Foreign Commerce, *Report on the Relation of Holding Companies in Power and Gas Affecting Control*, H. Rep. No. 827, 73d Cong., 2d Sess. (1933–1935) (Splawn Report), Part 2, page vi.

[52] From this point of view, Bond and Share was for a long time fantastically successful. The record establishes that at the beginning of 1928 Bond and Share controlled the subholding company systems of American, Electric and National with a combined net common stock investment of approximately *minus* $4,500,000 ($1,376,365 in American,

economy and must be curbed. (See Sections 1 (b) and (c) of the Act.) Thus, the Commission's findings that American and Electric were created and have always existed solely as instrumentalities for the perpetration of these condemned objectives (R. 534, 598–600, 634) establish that petitioners are the very complexities which it is the Act's purpose to eliminate.

With control of the entire enterprise in a top holding company common stock which represents a minimum of investment and a maximum of leverage, there is pressure to increase the leverage characteristics at each level in the holding company pyramid. *At the operating company level* this means, as the present record demonstrates, inflation of plant accounts and consequent obstruction to efforts of regulatory authorities to ascertain investment in aid of effective rate regulation.[53] Sale to the public of operating com-

$694,424 in National, and minus $6,500,000 in Electric). Those systems at that time had consolidated assets in excess of $1,000,000,000. At that time Bond and Share was receiving about $2,000,000 a year in dividend income from these three sub-holding companies and $6,000,000 in service fee income from their subsidiaries, of which the net profit represented probably two-thirds of that amount, or $4,000,000 (Commission Exhibit 68e, pp. 1810–15; R. 579). Thus, pyramiding, writeup and leverage produced a net annual income for Bond and Share of $6,000,000 on an investment of $1,500,000 less than nothing.

[53] For an example of a conscious attempt to confuse local regulatory officials, see the office memorandum from Samuel W. Murphy, then a member of Bond and Share's legal department and subsequently its president, to Frank A. Reid, its general attorney, wherein he emphasized the importance

pany debt securities and preferred stocks in amounts sufficient to recoup the entire cost to the holding company of acquiring control has been a deceptive practice, since the senior securities which investors bought did not have the cushion of junior investment they had reason to expect.[54] After an operating company becomes part of a leverage holding company system there is pressure to skimp depreciation in order to facilitate maximum dividend payments to the

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"of scrambling all these reorganizations together so that about the only thing the Pennsylvania Commission will be able to understand will be the result and not how the result was reached," and see the footnote comment thereon of A. D. Root, an employee of Bond and Share, as follows: "This plan at its present stage is for home consumption only, and I tried to make it simple for that reason. Is not scrambling just a matter of presentation?" Root also pointed out that the state Commission would be unlikely to see original costs "as they are all on Lehigh Books". (R. 823, n. 16, 17). The "Lehigh" referred to was Lehigh Power Securities Corporation, which was a Delaware incorporated subholding company in the Bond and Share system (Comm. Ex. 405A, 405B).

[54] Although the incomes of public-utility operating companies were, as is well known only moderately affected by the depression as compared with industry generally (see *The Electric Light and Power Industry in the United States*, Edison Electric Institute Statistical Bulletin No. 9 (1941), p. 39, Table 33), approximately one-half of the subsidiaries of American and Electric having preferred stock outstanding went into arrears of dividends on their preferred stocks because of their topheavy and inflated capitalizations, and in a number of cases maturing bond issues could not be met, with resulting Section 77B proceedings or bondholders' extension agreements. See e. g. New Orleans Public Service, Inc. (Comm. Ex. 821); Portland Gas & Coke Co., Tr. 9479. When the record herein was closed, a number of the operating companies still had substantial accumulated arrears on their

parent holding companies[55] and to finance plant additions exclusively by sale of new senior securities. Absent pressure from holding company parents, the operating subsidiaries of American and Electric companies would be free to sell common stock for new capital and thus avoid having their structures become progressively more ill-balanced and top-heavy as their outstanding senior securities increase through the years.[56] It has been the Commission's experience

preferred stocks which in some instances have since been eliminated pursuant to recapitalizations effected pursuant to the Act. See, e. g., *United Gas Corporation*, — S. E. C. — (1944), Holding Company Act Release No. 5271; *Mississippi Power & Light Co.*, — S. E. C. — (1944), Holding Company Act Release No. 4888.

[55] The record establishes that this was the general practice in the Bond and Share system. For example, in its findings (R. 603, n. 107) the Commission describes the case of Washington Water Power Company, which prior to the time that American acquired control had been consistently accruing for depreciation at a rate of approximately 3.37% of depreciable plant per annum, about the same amount as was claimed for income tax purposes. As soon as American obtained control, it reduced the book accrual for depreciation to 1.85% of plant, and *increased* the dividends paid on the common stock. In subsequent years depreciation accruals were further reduced.

[56] From date of acquisition by Electric to December 31, 1941, the combined debt of Electric's public utility subsidiaries increased approximately $106,000,000, preferred stocks increased $38,000,000, and common stocks less than $10,000,000. From date of acquisition by American to December 31, 1941, the combined debt of American's public utility subsidiaries increased $194,000,000, and preferred stocks increased $75,000,000 and as contrasted with an increased investment in common stocks of only $21,000,000.

that unsound holding company superstructures also served to embarrass regulatory agencies in their task of supervising new financing of the operating companies to the end that their financial structures be brought into balance.[37]

These unsatisfactory capitalizations of the operating companies are definitely among the evils which the Congress intended to correct through the Act (Section 1 (b) (1)). The concentration of voting control of the operating companies in the attenuated common stock equities owned by the holding companies also violates the expressed purposes of the Act against control with disproportionately small investment and against continuance of impediments to effective local regulation. Conversely, as we note below, the reversal of the process by which pyramided holding company systems were created, including the liquidation and dissolution of subholding companies, has eliminated water from operating company plant ac-

[37] In extreme instances where there has been urgent need of the operating companies to construct new facilities to serve the public and inability of parent holding companies to contribute equity capital, the Commission has found it impracticable, pending clean up of the holding company superstructure, to insist upon the new construction being financed otherwise than by adding new debt securities to an operating company already overbonded. See *In re Ohio Public Service Company*, 11 S. E. C. 104 (Cities Service Power and Light Company system), and *In re Virginia Public Service Company*, 11 S. E. C. 415 (Associated Gas and Electric system).

counts and provided them with more balanced capital structures.[58]

At the intermediate or subholding company level, the complications are at least equally serious. The petitioners have capital structures which are unsatisfactory from any point of view, and which are indisputably undue and unnecessary complications within the meaning of Section 11 (b) (2) of the Act. They are holding companies whose assets consist largely of *common stocks* of operating companies.[59] These common stocks of operating companies are preceded in asset and earnings claims by large amounts of

[58] As we show below, the opportunity to refinance at current lower rates high interest bearing bonds and high dividend preferred stocks which are presently outstanding, and to remove surplus impairments which would otherwise preclude declarations of dividends, may afford a financial incentive to reduce the leverage even where it means selling the holding company's interest in some operating companies to obtain cash for additional equity investment in other subsidiaries. Action of this kind has occurred in many of petitioners' operating subsidiaries since the Commission order under review, but has occurred as an incident to at least partial liquidation of petitioners rather than to their continued existence as pyramiding and leverage devices. See *infra*, pp. 107–114.

[59] Reference to the Analysis of Sources of Income chart which appears as Appendix B-2 to the Commission findings (R. 658) shows that the interest and preferred dividends which American received from its subsidiaries was approximately equal to its own interest charges. In the case of Electric, on the other hand, such interest income amounted to less than half of its own interest charges. Thus, so far as income is concerned, the preferred stocks of both petitioners rested exclusively upon the slender equities in the common stocks of the operating companies.

outstanding preferred stocks (sometimes as many as three different issues) and by mortgage bonds and sometimes debentures. Thus these common stocks are sometimes a fourth or fifth claim against the earnings of the operating companies. Upon these slender (and often nonexistent) junior equities, Bond and Share has reared the petitioners' structures consisting of bonds, two and three issues of preferred stocks, common stocks, and, in the case of Electric, option warrants.[60] Such holding company senior securities proved even more deceptive to investors than the inflated senior securities of operating companies.[61] In addition, the dangerous leverage factor, which is an inevitable concomitant of such pyramiding, affects the securities of the subholding companies as well as those of the top holding company.[62]

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[60] As noted above (p. 14, *supra*).

[61] See testimony of Commissioner Healy in Hearings Before House Committee on Interstate and Foreign Commerce on H. R. 5423, 74th Cong., 1st Sess. (1935), at p. 212.

"Commissioner HEALY. That is right. That is, you have the spectacle of people buying preferred stock in a holding company saying that they would not touch a common stock with a 10-foot pole, and when they look into the portfolio of the holding company and its assets, they see that they are common stocks, and they have bought common stocks without knowing it. And, the same thing is true of bonds. They rest upon those stocks."

[62] Appendix J to the Commission Findings shows the market range of American's stocks during 1925–1941, inclusive (R. 671). It will be noted, for example, that the market price of American's preferred stock has swung from a high of $107 per share in 1930 to a low of $11 per share in 1934 (all prior to the enactment of the Act), and that in

The problems of income and asset valuation resulting from the existence of these companies, to which the Commission referred in its findings (R. 626–627), are *not* confined to Bond and Share, as the petitioners urge in their briefs (Amer. Br. p. 84, cf. Elec. Br. p. 38). To be sure, they are especially severe in the case of Bond and Share, but they are very grave in the case of the petitioners themselves. It would be extremely difficult for most investors in American and Electric to appraise adequately their position in the system, a matter which is aggravated by dividend arrears.[63]

However, the complexities which the petitioners cause throughout the system are by no means merely those stemming from their capital structures. Even if their continued existence as pyramiding and leverage device structures were

a single year there has been as much as 400% change in such market prices. The common stock of American, having even more leverage, has swung about even more violently. The same table also shows how sharp and sudden gyrations have occurred in the earning power applicable to American's stocks.

Appendix K (R. 672) gives analogous figures for Electric. For applicable figures, equally significant, in the case of Bond and Share, see Appendix I (R. 670).

[63] American contends (Br. p. 68) that preferred arrearages are a "financial condition" and therefore cannot be deemed a "complication of structure." So is the capitalization of a company a "financial condition," yet we assume it will not be argued that it too does not go to "complication of structure." Aside from the obvious *non sequitur*, we submit that mountainous preferred arrearages, constantly increasing, are a complexity of the most serious kind whose effects extend throughout the system.

in themselves tolerable, petitioners would, as we have shown, continue to complicate unduly the Bond and Share system.[64]

2. American and Electric serve no useful purpose either functional or financial

The theoretical justification for utility holding

[64] The Commission also found that the continued existence of American and Electric would cause substantial unnecessary expense to their security holders. In the case of American these expenses (including taxes) exceeded $1,000,000 in 1941, and in the case of Electric they came to $490,000 (R. 634). These expenses more than offset the $300,000 increased dividend expense which American claimed would result from direct ownership of the operating subsidiaries by its investors plus an unstated amount of increased transfer costs which are the only specific disadvantages adduced to support petitioner's due process arguments (Amer. Br., pp. 24–25, 38). (American also complains of taking the corporate right to exist and hold its present properties and its security holders' right to continue their investments in present form, and refers to the alleged advantage of diversification through investments in holding companies.) Petitioners contended below that by filing consolidated tax returns they save their subsidiaries even larger sums. The short answer is that no such evidence was before the Commission, either by direct presentation or by filing of requested findings, exceptions to findings or otherwise. Moreover, even assuming such savings, there is no way of knowing whether consolidated returns, which became permissible under war time revenue laws that included the excess profits tax, will be permitted under future tax laws. If the privilege of consolidation should be removed, the partial tax on intercorporate dividends would accentuate the burden to security holders of continuing a useless holding company. Furthermore, the continued existence of otherwise useless and harmful corporations can hardly be justified on the ground that they serve as devices to reduce taxes.

companies is that they supervise and coordinate operating company subsidiaries both in their operations and in their financing. Whatever Bond and Share has accomplished in these directions (and we do not mean even by implication to concede that it has benefited either investors or consumers), American and Electric have not performed these functions and are not capable of performing them.

(a) *Lack of function as to operating matters*

Throughout their entire existence and until November, 1935 (the date when the registration provisions of the Act become effective), the petitioners were mere "paper" companies and did not have a single employee of their own. All officers of the petitioners were employees of Bond and Share paid exclusively by it, and all activities performed for or in the name of the petitioners were performed by employees of Bond and Share. More than a majority of the Boards of Directors and Executive Committee of the petitioners at all times consisted of employees and directors of Bond and Share or persons closely affiliated with it. All actions taken in the name of the companies were performed by employees of Bond and Share. Even when these companies were engaged in dealing with Bond and Share in the purchase of assets involving hundreds of millions of dollars (including enormous profits for Bond and Share),

they were represented solely by employees and counsel of Bond and Share. Their subsidiaries were managed in every detail by Bond and Share.[65] (R. 562–563, 592–594.)

In practical operation, no heed was paid to subholding company lines; the subsidiaries of American, Electric and National were managed on a *geographic*, not a sub-holding company, basis (R. 593–594, n. 102).[66] In short, corporate lines and identities were wholly disregarded. There was one large organization, and that organization was Bond and Share.[67] Functionally, the petitioners were, as the Commission found, mere sets of books in Bond and Share's office (R. 592).

The foregoing represented the situation until November, 1935. At that time, certain formal

[65] See, for example, the so-called "service contract" in force between American and Bond and Share from 1917 until 1929 (R. 825–835).

[66] It will be recalled that the subholding company systems (with the exception of American Gas & Electric) had been assembled as a matter of financial convenience and without regard to geographic relationship between the operating companies. The pattern of scatteration which resulted appears from the maps, Appendices B and C, *infra*.

[67] Cf. testimony of L. B. Wiegers, Secretary and Treasurer of Bond and Share (Tr. 450):

Q. (Mr. MacLane). "So is it fair to summarize the situation as it existed up to November 1935, by saying that from the standpoint of official and clerical personnel, Electric Bond & Share Company and these three holding companies, American, Electric and National, might be regarded as a single organization, save as strictly corporate action was taken separately by the boards of directors and stockholders of the different companies?"

A. "That is correct."

steps were taken on the advice of counsel [68] which, as the Commission found, effected no fundamental change. Thus, the names of American, Electric and National were lettered on the doors of a few offices in the Bond and Share office building at No. 2 Rector Street, and a handful of Bond and Share employees, together with the respective corporate books of accounts, was moved into each of these offices. The Bond and Share service section placed the name "Ebasco Services" on its office doors and was separately incorporated, with Bond and Share owning all its stock.[69] The "service contracts" which all the operating subsidiaries of American, Electric and National had always had with Bond and Share were assigned to Ebasco Services (Comm. Ex. 68a, p. 335). Directors were shifted about to avoid formal interlocking. This was all. (R. 592–598.)

The practical operation of the system continued as it had prior to 1935. The operations of the public utility companies of the system continued to be supervised and dominated by Bond and Share, in the same manner as when its service section was not called Ebasco Services Incor-

[68] Tr. 6859–60; Tr. 8613–14.

[69] Until 1940 the officers of Bond and Share were the officers of Ebasco Services. In 1940, when the Commission held that the arrangement was violative of Section 13 of the Act, S. R. Inch, President of Bond and Share, dropped his post in Bond and Share to remain as President of Ebasco Services. See *Ebasco Services Incorporated*, 7 S. E. C. 1056, 1075–1079 (1940).

porated. Subholding company lines continued to be disregarded (R. 593–594, n. 102). Budgetary and reporting controls continued to be exercised by Bond and Share (through Ebasco) (Comm. Ex. 1051 A and B). Even the New York bank accounts of the subsidiaries of American, Electric and National were still in the hands of Bond and Share (through Ebasco) (R. 604, n. 109). The personnel of the subholding companies, as the Commission found (R. 597–598), "have functioned since November 21, 1935 as subsidiary and complementary organizations of Bond and Share, possessed of substantially the same outlook, objectives, and loyalties as they had prior to November 1935."[79]

Each of the petitioners has a staff of from fifteen to twenty employees, consisting in the main of the corporate officers and a few clerical assistants (R. 593–595). This personnel, the Commission found, "is sufficient merely to perform necessary routine activities incident to the functioning of the subholding companies as corporate owners of securities" (R. 597).

As compared with the slender staffs of the petitioners, it is to be noted that each of the 16

[79] To such an extent is this true that the President of National indicated that he regarded the 1935 revision as something of a nuisance which had resulted in increased expense and decreased efficiency—a nuisance which counsel advised was made necessary by the Public Utility Holding Company Act if the existence of the subholding companies was to continue. He testified that he "would be delighted to go back to the old arrangement" (R. 598).

public utility subsidiaries of American has "a comprehensive complement of skilled personnel," the total for the group aggregating in excess of 12,000 officers and employees (R. 542). Similarly, each of Electric's 10 operating utility subsidiaries is fully staffed with expert personnel, the aggregate for the group being in excess of 14,000 officers and employees (R. 548–549).[71] In addition, each of the subsidiaries of American and Electric has contractual arrangements, for which it pays substantial fees, entitling it to receive continuous consultative assistance from Bond and Share's wholly-owned service subsidiary, Ebasco Services Incorporated. This organization has a staff of 630 employees in the United States Division and 156 additional employees in its Foreign Division, consisting mainly of professional personnel, such as accountants, analysts, and engineers. (R. 616, n. 128).

The technical needs of the petitioners' subsidiaries thus being fully cared for, as the Commission found, there remained no role in the operations of their subsidiaries for the petitioners to play, and even if there were, the petitioners were not equipped to perform it (R. 634, 645).

Further evidence that the subholding companies were not designed to coordinate or supervise

[71] The record contains an itemized payroll list for each subsidiary of American and Electric, and a functional chart showing how the personnel of each subsidiary is departmentalized and integrated to form a cohesive utility organization. For examples, see Commission Exhibits 279 and 478.

the activities of their operating company subsidiaries is found in their geographic grouping. An examination of Appendices B and C attached to this brief shows that American's subsidiaries are scattered from Florida to Washington and from Minnesota to Texas. Those of Electric are similarly dispersed from Mississippi to Oregon. From an operational point of view no conceivable plan for coordination can be found in the grouping of these companies under their subholding companies, and, as we have seen, their actual management ignores these lines.

(b) *Lack of function as to financial matters*

Before the Commission and the court below, petitioners argued (See, e. g., R. 600) that they serve as useful financing media for assembling scattered properties into compact and integrated companies and for furnishing equity capital and cash advances to their operating subsidiaries. Examination of this claim shows that it is baseless.

The argument made by petitioners relates primarily to past situations. It is clear that the companies presently and in the future can serve no function in assembling properties or in furnishing capital or cash to these subsidiaries.[72] Both

[72] We note below that incident to the partial liquidation of petitioners substantial cash has been generated, some of which has been utilized to strengthen the financial structure of the operating subsidiaries. This does not indicate that their continued existence would serve as a medium of raising new funds.

petitioners have at the present time vast accumulations of unpaid preferred dividends in arrears; neither was able to meet its dividend requirements throughout the ten years ending in 1941. In the light of their financial records (R. 540, 547, 632) and the standards of the Act (see Section 7 (d)), petitioners are in no position to raise capital through the sale of new securities. Such capital would be necessary in furnishing financial benefits to existing operating companies or in assembling properties into compact and integrated companies. And, under the Act, it is clear that under no circumstances could petitioners acquire additional scattered properties for any purpose. Indeed, even were petitioners permitted to continue to exist, they admit they would be required to dispose of their presently scattered properties and limit their systems to single integrated systems.

Petitioners, however, insisted that they be permitted to show their past activities to establish their valuable past functions as bearing on their present and future usefulness (R. 534), but examination of their past performance failed to reveal any past function other than the harmful functions of pyramiding and leverage referred to above. Thus the acquisition and combination of properties was not accomplished by petitioners in a manner designed to advance the interests of the investing or consuming public. The properties acquired were most frequently unrelated and not

subject to integration through common holding company control.[73] In certain instances the properties were already largely under the control of a single holding company, and the sums expended were merely to gain control of investments from other financial interests.[74] In view of the general competitive scramble for control of properties which was conducted with mounting fervor by rival holding company systems throughout the twenties, properties were obtained at prices bear-

[73] For example, at organization, Electric acquired control from Bond and Share and from another of Bond and Share's subsidiaries of four developed public utilities located in the states of Utah, Idaho, Texas, and Louisiana, respectively (R. 571, n. 70 and R. 573–575). This was precisely the type of control of unrelated properties which Congress found to be completely inimical to the public interest and which it condemned in the Act. See Section 1 (b) (4). Moreover, in the process Electric entered in its investment accounts at $69,900,000, securities which had cost Bond and Share and associated companies not more than $23,245,000 (R. 582).

[74] For example, see the acquisition by Electric of securities in the so-called Arkansas, Louisiana, and Mississippi group. The greater part of these securities had been assembled in a holding company called Southern Power & Light Company, which was controlled by other utilities and banking interests (R. 583–584). In order to give apparent asset support for the securities issued by these operating companies under Electric control, the plant accounts "were stated at a sum equal to approximately 144% of the combined plant accounts on the books of predecessor companies and 175% of predecessor plant accounts after adjustments for removal of identifiable inflationary items on predecessors' books" (R. 585).

ing no reasonable relation to their original cost."[76]

[75] For example, in 1925 American purchased the common stock of Northwestern Electric Company from the Fleishacker banking interests of California, which had organized the company in 1911 and operated it since. American paid the Fleishackers $5,000,000 for this stock, which the Federal Power Commission has since held was all "water" and must be written off (Tr. 10154 and F. P. C. Opinion No. 56). The order of the Federal Power Commission was sustained in *Northwestern Electric Co.* v. *Federal Power Commission*, 321 U. S. 119. Similarly, in 1928 American issued $153,333,620 of its own preferred stock to purchase control of two large and prominent utilities, Washington Water Power Company and Montana Power Company. The book value of these securities was approximately half the amount paid by American, and in the case of Montana $49,000,000 of this book value, representing the entire common stock, was water. (R. 566–567.)

See also footnotes 73 and 74, *supra*.

Cf. Report of National Power Policy Committee, H. Doc. No. 137, 74th Cong., 1st Sess., transmitted by the President to Congress on March 12, 1935 (this report was printed in full as an appendix to the Government's brief in *Otis & Company* v. *S. E. C.*, 323 U. S. 624):

"The growth of the holding-company systems has frequently been primarily dictated by promoters' dreams of far-flung power and bankers' schemes for security profits, and has often been attained with the great waste and disregard of public benefit which might be expected from such motives. Whole strings of companies with no particular relation to, and often essentially unconnected with, units in an existing system have been absorbed from time to time. The prices paid for additional units not only have been based upon inflated values but frequently have been run up out of reason by the rivalry of contending systems. * * * they have too frequently given us massive, over-capitalized organizations of ever increasing complexity and steadily diminishing coordination and efficiency.

"For all this concentration so dangerous to his democracy, the American consumer pays the bill. With a large and often

In many cases [76] the acquisition and combination of the properties were made by Bond and Share before ownership was placed in petitioners.[77] Petitioners, as mere tools of Bond and Share, exercised no initiative or judgment of their own.

As the Commission found, outlays made by petitioners in the combining of operating companies "were purely transitional and not at all in the nature of equity capital". (R. 603). Indeed, in some cases petitioners did not even provide funds for these transitional outlays; they were loaned by Bond and Share or by their subsidiaries (R. 604).

Nor were petitioners of substantial aid to their subsidiaries subsequent to their organization. The Commission found that "in the entire thirty-

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unsound capitalization to support, many holding companies have not been able to be satisfied with reasonable dividends on the securities of their operating companies * * *."

[76] Testifying before a Congressional Committee, S. R. Inch, then President of Bond and Share and now President of Ebasco Services Incorporated, stated:

"Mr. MAPES: Why could not that all be done by the Electric Bond and Share Co.?"

Mr. INCH: "It could, except that it was not at that time. I do not know whether it was wise or not; but it has worked, and that is really the test of usefulness as to these things. It was thought desirable when that group was done to close it and go on and do another job and *then to get the new investors that might come into that, you see.*" [Italics supplied.]

Hearings on H. R. 5423, 74th Cong., 1st Sess. (1935), (R. 599).

[77] See e. g. R. 554–558, 568–576.

two-year history of American, the record indicates only four instances of purchases of common stock of subsidiaries subsequent to organization, none of which constitutes an impressive instance of the supply of 'risk capital'" (R. 604).[78] Electric made an additional investment in only four of its operating companies after obtaining control of them.[79] The record demonstrates that it has been the public investors in the subsidiaries of American and Electric who have supplied virtually all of the capital that has gone into the development of such subsidiaries.

The record demonstrates also the unsoundness of any claim that the petitioners conferred bene-

[78] The four instances are detailed in footnote 110 of the Commission's findings (R. 604–5). They amount to $6,700,000, which for purposes of comparison must be placed beside the figure $840,760,062 at which the total assets of the subsidiaries of American were carried on their books as of December 31, 1941 (R. 665).

[79] The four instances are discussed in the Commission's findings (R. 587–591, 605–606). Aside from the United Gas Corporation, all its investments amounted to $5,802,500. Electric paid $60,000,000 cash into the treasury of United Gas Corporation. But as quickly as it was paid into United's Treasury, United paid out $36,000,000 of this to Bond and Share in partial repayment of a loan which Bond and Share had previously made to the predecessor of United. $21,000,000 of the remainder was used by United in payment of a bank loan the proceeds of which it had paid to Bond and Share in further repayment of an indebtedness to Bond and Share on the same loan. United Gas Corp. Record, Tr. 723–7, 2202–21 and Comm. Exs. 214–A–B, incorporated in this record by reference. Thus, Electric's investment was used to bail out Bond and Share.

fits on their subsidiaries by making substantial short-term loans. Many of such loans were arranged to make possible the payment of dividends to the petitioners and thus represented no more than book entries designed to inflate the income accounts of the petitioners. (R. 607.) To a large extent the subsidiaries themselves through upstream loans to American and Electric furnished monies for short-term loans to other subsidiaries, at interest rates higher than those which banks would have charged the borrowing subsidiaries on the same loans (R. 607–608). The holding company policy of restricting the cash and working capital of the subsidiaries to a minimum furnished the excuse for loans from the subsidiaries, and since these were in the essence mere demand loans the subsidiaries "could be, and at times were, placed in difficult and costly situations by the untimely demands of hard-pressed subholding companies" (R. 608–609, and see note 118). The Commission found that: "Whatever may have been the situation in the past, we note that subsequent to November 1935, American and Electric have made loans to subsidiaries in perhaps a dozen instances, the amounts involved being relatively small and in most cases for very short periods. Since the subholding companies charged from 3 to 6% on loans which almost certainly could have been obtained by the subsidiaries from banks for less, it is clear that the transactions were designed to benefit the subholding companies rather than the subsidiaries

and were actually at the expense of the subsidiaries" (R. 609–610).[80]

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The Commission's recital of the development of the Bond and Share system shows irrefutably that petitioners are paper companies, super-

[80] The United Gas Corporation situation illustrates the manner in which Bond and Share and petitioners have failed to help the operating companies financially. Since 1936 Bond and Share collected 6% interest on debt claims against United Gas totalling $53,000,000. There is little doubt that this debt could have been refinanced at the banks for not more than 3% (Tr. 4458–59). However, when the president of United Gas asked Bond and Share to reduce the interest, it was explained to him that Bond and Share needed to continue to receive 6% interest to service its own securities. (See testimony of J. H. Gill in *United Gas Corporation* (Tr. 4475, 4522–24), incorporated into the record of this proceeding by reference). Electric, which held large amounts of United Gas second preferred stock on which arrearages were accumulating, did nothing to protect the interests of its security holders. The public security holders of United Gas and of Electric continued to watch the arrearages pile up, while Bond and Share continued to collect its 6% interest. If United Gas had been free of the "financial assistance" of its parents, it could have cut the cost of carrying the "debt" by at least $1,500,000 a year.

Actually, after the close of this record, the Commission approved a reorganization program of United pursuant to Section 11 (e) whereby all Bond and Share's direct interest in United was eliminated so that United no longer pays interest or dividends to Bond and Share. The proceeding involved a compromise of Bond and Share's claims at $44,000,000, the difference being a settlement of contention that Bond & Share's claim should be subordinated. Refinancing was achieved primarily through the sale of a 3% bond issue. *United Gas Corporation, et al.* — S. E. C. — (1944), Holding Company Act Release No. 5271. See pp. 112–113, *infra*.

fluous from any functional point of view, conceived and utilized by Bond and Share solely to serve functions which Congress had determined to be opposed to the public interest. We submit that the record not only supported, but made inevitable, the Commission's findings that the existence and capital structures of American and Electric unduly and unnecessarily complicate the structures of the holding company systems of which they are a part.

II

IN THE LIGHT OF THE COMMISSION'S FINDINGS THE REMEDY OF DISSOLUTION IS PROPER

Having found that the corporate structure and continued existence of the petitioners unduly and unnecessarily complicated the structure of the Bond and Share system and inequitably distributed voting power among security holders of the Bond and Share system, and also that the petitioners' own structures were unduly complicated and involved inequitable distribution of voting power among the security holders of their own holding company systems, the Commission concluded that dissolution of petitioners was "necessary to ensure" correction of this situation and compliance with the standards of Section 11 (b) (2) of the Act.

Petitioners' challenge to the Commission's choice of this remedy is, as we have noted, the

focal point of their present arguments.[81] As the court below observed (R. 889), the question thus raised is whether there was any rational basis for ordering dissolution of petitioners in order to achieve compliance with the statute, and as this Court has stated, "the relation of remedy to policy is peculiarly a matter for administrative competence." See *Phelps Dodge Corporation* v. *N. L. R. B.*, 313 U. S. 177, 194; also *International Association of Machinists* v. *N. L. R. B.*, 311 U. S. 72, 82; *N. L. R. B.* v. *Falk Corporation*, 308 U. S. 453, 458; *Federal Security Adm'r* v. *Quaker Oats Co.*, 318 U. S. 218, 233.[82]

In determining that dissolution of petitioners was the appropriate remedy the Commission stated that "the action we must order to be taken is such as seems to us calculated to" correct the situation "most effectively and quickly, ever bearing in mind the stated policy of the Act to provide *as soon as practicable* for the elimination of all holding companies except as expressly provided in the Act." (R. 635.) The Commission stated that "while

[81] We discuss below (pp. 156–165): the contention, not made before the Commission, that the remedy of dissolution is not authorized by the statute.

[82] The obvious reason for entrusting the present task to an administrative agency was to accord with the recommendation of the National Power Policy Committee that this was necessary "to attain the flexibility desirable for the handling of this complicated problem in a realistic and prudent way." See appendix to Senate Report, 621, 74th Cong., 1st Sess., p. 58.

some measure of amelioration in their [petitioners'] statutory offensiveness might be afforded by other approaches, in our opinion no approach presently available holds out the promise of effectuating the statute's requirements fully or promptly" (R. 636). This conclusion accords with the recommendation of Dr. Walter Splawn, one of the experts upon whom Congress relied in enacting the Act, who specifically pointed out that:

> The most effective means of preventing pyramiding is to eliminate the so-called intermediary company interposed between the operating company and the company at the top.[83]

The Commission rejected "as wholly untenable respondent's [petitioners'] contention that in carrying out our duties under Section 11 we cannot find 'necessary' a course of action for which some alternative may be present, since such a construction would lead to the result that we should be rendered impotent to require *any* action where several courses of action appeared available to achieve the statutory objectives" (R. 639). As we have seen, however, the Commission stated that there were no alternatives to dissolution which offered comparable promise of ensuring compliance with the statute. For that reason, the Commission rejected such alternatives as appeared to it implicit in petitioners' so-

[83] Splawn Report, Pt. 2, p. VII, made pursuant to H. J. Res. 572 (72d Cong., 2d Sess.), referred to in Section 1 (b) of the Act.

called Section 11 (e) "plans." To show that the Commission's choice not only had a rational basis but involved an eminently fair and practical solution to a complex administrative problem, we state below the nature of that problem with particular reference to the following questions: (1) What is the function of a Section 11 (b) order in relation to the administration and enforcement of Section 11? (2) What are the practical consequences of the instant dissolution orders? and (3) What, if any, alternatives were open to the Commission?

1. *The enforcement function of a Section 11 (b) order.*—The requirements of Section 11 are not self-operative but require implementation by the Commission and the federal courts before any sanctions attach. The enactment of the statute gave notice to the industry that major changes would be required in the organization and structure of the typical holding company system. Thus, in the case of petitioners it was recognized from the outset that unless their constitutional objections should prevail, dissolution would be required.[84] From the effective date of the statute the holding companies were free to seek

[84] As we noted, *supra*, p. 37, in their answer in the registration suit which was before this Court (*Electric Bond and Share Company* v. *Securities and Exchange Commission*, *supra*) these petitioners stated that the threatened enforcement of the Act would "leave them with no alternative but to dissolve". Comm. Ex. 69 (Vol. 1, p. 177).

Commission authorization of transactions which would be accomplished under their existing corporate powers and which might, as partial steps toward compliance with Section 11 (b), reduce to more manageable compass such further action as might be required. In addition, at any time after January 1, 1936, the holding companies were also authorized to invoke the reorganization powers of the Commission and of the federal courts in accordance with the provisions of Section 11 (e). It was not, however, until after January 1, 1938 that the Commission could require by order, after notice and opportunity for hearing, the action or steps which the Commission should find necessary for simplification.[85] Hearings under Section 11 (b) can be and were in this case prolonged. Even the entry of an order under Section 11 (b) carries no immediate compulsion, for the penalties prescribed by Section 29 for violation of Commission orders are expressly made inapplicable to orders under 11 (b). Section 11 (c) provides that such an order under Section 11 (b) is to be

[85] As the Commission stated in its Seventh Annual Report to the Congress (p. 73), it did not begin the institution of Section 11 proceedings against the major utility holding company systems until the spring of 1940, approximately two years after the termination of the original litigation over the constitutionality of the registration provisions of the Act, the additional two years' opportunity given the holding companies to submit voluntary plans having resulted in the submission of plans which "amounted to little more than arguments attempting to justify the retention of the existing scattered holdings."

complied with within a year, subject to the possibility of an extension of time of an additional year. If, nevertheless, compliance does not occur the Commission cannot enforce its order without applying to a federal district court, pursuant to Section 11 (d). In such an enforcement proceeding the court may appoint a trustee who, with court approval, is authorized to dispose of the respondent company's assets, including disposition in accordance with a fair and equitable reorganization plan theretofore approved by the Commission.

Thus, the function of a Section 11 (b) order is to implement the original statutory mandate for simplification by a more specific prescription of what is to be done, and to do so in an order which in default of voluntary compliance must be susceptible of court enforcement. Because of the complexity of holding company organizations, as exemplified in the present record as well as in the studies referred to in Section 1 (b) of the Act, and because of the time lag between entry of the order and court enforcement, such an order must allow substantial latitude as to detail and yet be sufficiently specific to afford the respondent company in the first instance, and ultimately a court-appointed trustee, a definite goal to be achieved.

Such an order is a step in an over-all process by which it was intended to make the compulsions of the Act "sufficiently clear to convince the interlocking lawyers of the holding-company bankers

that it can't be evaded or compromised," whereupon it was hoped that "the legal and economic imagination which put these holding-company combinations together will devise many means of taking them apart."[88] While it was to be expected, in view of the opposition of the holding company industry to Section 11, that many ingenious legal arguments would be interposed against the entry of any order compelling any action, once it is established that the existing status contravenes the standards of Section 11 (b), the problem of determining the appropriate order is not one of legal dialectic but of practical administration.

Electric complains (Br. p. 22) of the "sporadic and halting manner in which the Commission has

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[88] Additional views of Congressman Eicher appended to House Report No. 1318, 74th Cong., 1st Sess., p. 50. Congressman Eicher added:

"But pending the certainty of such compulsions the legal and financial advisors of the holding companies have not been concerned to discover how the proposed legislation will work; they have only been concerned to discover reasons why it won't work."

In the course of administration also, the Commission has been confronted with great legal ingenuity on the part of counsel in suggesting reasons why particular orders will not work, but these have been accompanied by practical demonstrations on the part of other holding company managements and other counsel as to how compliance can be effected to the advantage of their security holders. Not infrequently the legal battle to protect the holding companies against being compelled to do anything has been almost contemporaneous with, if it did not overlap, substantial compliance by the same holding company management.

proceeded with respect to the system of Bond and Share and the system of Electric and the other sub-holding company systems, culminating in the dissolution of Electric and other sub-holding companies." Perhaps it is only modesty which prevents Bond and Share from claiming some credit for such halting administration.[87]

It is interesting to note that while petitioners now criticize the orders under review as unduly circumscribing their freedom of action because, as they contend, some remedy less than dissolution might have served to correct the statutory evils, petitioners argued in the court below that the orders do not meet the requirements of the intro-

[87] Despite the fact that Bond and Share and petitioners recognized from the outset that Section 11 would require dissolution of petitioners, no action of substance was taken toward that end until after the entry of the orders in the instant case. Bond and Share's original proposals in response to the inquiries of the Commission referred to in the Electric brief (p. 20) involved nothing more than a proposed re-grouping of the Bond and Share subsidiaries on a geographical basis, without any suggestion of dissolution or severance from Bond and Share, or other fundamental change. These proposals, renewed with some revision in text as recently as September, 1940, assumed that Bond and Share's control rather than that of the sub-holding companies was the focal point for integration under Section 11 (b) (1). See respondents' Exhibits 4 and 4a. When proceedings were started under Section 11 (b) (1), petitioners urged that certain exemption matters had to be disposed of first. Their procedural contentions in these proceedings are detailed in the Commission's opinion. (R. 529.) See also the objections not raised before the Commission but urged before the court below. (R. 876.)

ductory clause of Section 11 (b)[88] in that they do not prescribe in sufficient detail the "steps" which petitioners must follow in the dissolution process.[88] In fact, the orders have left them great latitude as to the methods of compliance; and, as the Commission pointed out in its opinion (R. 647–648), the next to last sentence of Section 11 (b) would permit revocation or modification of the dissolution orders if in the course of their efforts toward compliance petitioners bring about a situation in which their dissolution is no longer necessary to achieve the statutory objectives.

2. *What dissolution of a holding company such as petitioners involves.*—In the legislative battle over the passage of the Holding Company Act the opponents of Section 11 coined the phrase "death sentence" to symbolize their claim that the dissolution and simplification of holding company systems would be destructive of economic values. The contrary view as expressed, for ex-

[88] That dissolution orders are in fact sufficiently definite to permit voluntary compliance by the companies is indicated not only by the anti-trust precedents relied on by Congress (see *Northern Securities Co.* v. *United States*, 193 U. S. 197, and *United States* v. *American Tobacco Company*, 221 U. S. 106), but by the fact that other holding company respondents, including petitioners' associate company, National Power and Light, have found no difficulty in understanding how to comply with such orders. The relevant considerations for not entering orders more specific as to detail are similar to those which moved the industry to urge that compliance with the integration and simplification standards of the Act should not be placed by Congress in a "straight-jacket" (p. 151, note 127, *infra*).

ample, in Senate Report No. 621, 74th Cong., 1st Sess. (1935) was that dissolution of useless holding companies would merely provide a sounder organization for the underlying utility business, and preserve all intrinsic values.

Thus the Senate Report states (pp. 16–17):

> An argument has been given wide-spread currency by the opponents of the title that the elimination of the giant holding companies will demoralize the market for all operating securities because many operating-company securities will be thrown upon the market by the giant holding companies in the course of their dissolution. The argument is premised on the false assumption that the proposed title will cause the dumping or forced liquidation of securities by the giant holding companies. As has been explained above, the title does not require the dumping or forced liquidation of securities. Such disposition as may be necessary can be accomplished by reorganization which will equitably redistribute securities among existing security holders. Insofar as there may be some redistribution of the securities of operating companies through investment banking channels, this will not result in a substantial net increase in the supply of utility securities on the market because for every block of operating securities distributed there will be a corresponding block of holding-company securities retired. The net effect of such changes will be to strengthen the

market for utility securities generally by replacing holding-company securities with sound operating-company securities. Such operations, primarily of a refunding nature, should strengthen rather than weaken the credit of operating companies.

The market for operating-company securities will be no longer adversely affected by the disrepute into which holding-company securities generally have fallen. The individual investor in present-day holding companies should come out of any reorganization process under the title with far better securities than those with which he went into it. He should get a security which represents an actual down-to-the-rails investment in a regulated local operating company, or, at most, a regulated regional holding company. He should get a security which will bring him, instead of paper stock dividends, all the legitimate cash dividends the operating company can pay—not what is left of them after high salaries, large fees, bonuses to holding-company officers and bankers, and the purchase of securities at exorbitant prices from corporate insiders. In short, the individual investor should receive the kind of a security he thought he was buying in the first place. The actual clearing up, through clean reorganizations, of the tangle in which holding-company finance has left the industry and those who have invested in it, can reestablish a confident, stable market for good utility securities. But a fright-

ened policy of refusing to take hold of the obvious political and financial difficulties of the industry will only generate even greater future difficulties.

Dissolution of a holding company, in its simplest terms, involves nothing more than peeling off a corporate shell between the revenue producing properties of the operating subsidiaries and the ultimate individual investors who are the owners, directly or indirectly, of securities in the holding company to be dissolved. If petitioners had simple capitalizations consisting of a single class of common stock, and if their operating subsidiaries were in such shape that distribution of petitioners' holdings of their common stock would be consistent with the public interest and the interest of investors, compliance with the dissolution orders would involve nothing more than paying a liquidating dividend in kind. As a result of such liquidation both Bond and Share and the public security holders of the subsidiary holding companies would acquire direct interests in the operating companies in lieu of their existing indirect interest through stock of petitioners. The immediate effect would be that the same persons would have virtually identical interests in the same underlying businesses, but interests represented henceforth by separate certificates for each company, in lieu of the present state where their indirect interests in the various operating companies are not severable by indi-

vidual action but are represented by a single certificate of stock in the subsidiary holding company.

Dissolution of petitioners even under such circumstances would correct undue complexity in the Bond and Share system. It would be advantageous, moreover, both to the public security holders of petitioners and to Bond and Share, which has its own problems of compliance with Section 11, to be able to make separate disposition of securities in individual companies rather than having to deal with the stock of petitioners, representing an interest in a number of operating companies.

If, therefore, petitioners and their subsidiaries had the healthy financial structures which we have assumed for purposes of illustration, it is doubtful whether they could have any motive, with the possible exception of ephemeral tax considerations,[89] for resisting a dissolution order, and certainly there would be no basis for characterizing the remedy as in any way drastic. The facts that petitioners have such complex security structures and that at the time of the orders, many of their subsidiaries needed a financial house cleaning before petitioners' stock interest in the subsidiaries could be put in condition suitable for disposition make the process of dissolution prescribed by the order under review more complex than in the over-simplified case we have supposed; but these circumstances

[89] See footnote 64, p. 80, *supra*.

only made dissolution the more imperative to ensure correction of the respects in which petitioners' existence and structures had been found to contravene the standards of Section 11, and in order also to increase the resulting benefits to the investors in the system.

The nature of the financial house cleaning required by petitioners' subsidiaries is apparent from the Commission's findings as to the enormous write-ups in their asset accounts and the deficiencies in depreciation reserves; from the slender common stock equities after allowance for inflation in their accounts; from the fact that the interest and dividend rates on their publicly held bonds and preferred stocks were relatively high under the then "cheap money" conditions (see Appendix B–2 and B–3 of the Commission's Findings and Opinion, R. 659–660); from the complications caused by the existence of holding company debt claims and controversies as to the possible necessity for their subordination to publicly held preferred stocks; and from the fact that such elimination of inflationary items as might be required by the Commission or by other authorities having accounting jurisdiction might leave impaired surplus accounts and thus prevent payment of dividends out of current earnings unless the companies should undergo accounting reorganizations and recapitalizations. The requirement that petitioners liquidate and dissolve has both facilitated and furnished additional in-

centive to this process of financial house cleaning for the subsidiaries, a process which, in addition, might perhaps have been prompted by business considerations quite apart from the necessity of compliance with the Act.[90]

Dissolution also involves dealing with petitioners' own complex security structures, and satisfying the respective claims of the holders of their debentures and preferred and common stocks. Apart from the considerations that made necessary the further step of dissolution, substantial simplification of petitioners' own security structures was necessary in view of the Commission's finding that those structures cause undue complication and inequitable distribution of voting power in their own holding company systems. By reason of the fact that petitioners' own stratified security structures rest substantially upon common stock of operating companies, junior to large issues of publicly held debt securities and preferred stocks, it is essential that such simplification be carried to the point of substituting a single class of stock for petitioners' existing debt

[90] The dissolution order did not in terms require changes in the subsidiaries. The necessity for such changes as a preliminary to dissolution flows in part from the business considerations mentioned in the text and in part from the necessity that dispositions conform to the public interest standards of the Act. In addition, Section 11 (b) (2) would in many instances require recapitalization of the subsidiaries to correct inequitable distribution of voting power.

as well as their preferred and common stocks.[91] The necessity for such action was at least partially recognized by petitioners' own Section 11 (e) plans, since each of these plans proposed substitution of a single class of stock for various classes of stock presently outstanding, and indicated the need for retiring their debt, although somewhat vaguely in the case of Electric (R. 464, 467). The dissolution orders did not preclude such action. The dissolution orders left it open to petitioners, in the first instance, to propose methods of dealing with the successive claims of debenture holders and preferred stocks whether by way of preliminary partial plans of compliance or in a comprehensive plan of distribution in kind. In discussing American's plan, its President, H. L. Aller, testified that in this respect there would be no real difference between compliance with a dissolution order and the carrying out of any reorganization of American.[92]

The process of dissolution in such circumstances

[91] See *Commonwealth and Southern Corporation* v. *S. E. C.*, 134 Fed. 2d 747 (C. C. A. 3).

[92] R. 274. (Direct examination by Judge MacLane):

"Q. Do you regard this reclassification of stock as essential to any reorganization of American, or even to its dissolution? A. Yes, I regard it as highly essential. If American Power & Light Company is to be either reorganized or dissolved, the reclassification of stock will permit American to distribute values without wasting of those values, as would result if it were compelled to liquidate through a substantial sale of properties. It was felt that the sale of properties should be limited to as small an amount as necessary to facilitate the satisfaction of the debt of American."

can be a highly salutary process, as has been demonstrated in the steps taken by a number of holding companies to comply with dissolution orders. Indeed, it is demonstrated also by the action of petitioners' sister company, National Power and Light, which did not challenge the dissolution order, and has carried it out to the extent of filing a plan for its final liquidation, as well as by the partial action which petitioners themselves have taken despite the pending litigation.[93] In this process some operating companies have been sold for cash at prices deemed advantageous by the management. With their cash resources, augmented by such sales, and their holdings in the senior securities of operating companies, petitioners and Bond and Share have been able with Commission cooperation to bring about successive clean-up operations in the various operating companies.

For example, subsequent to the closing of the record in this case, Florida Power & Light Company consummated a conspicuous example of a successful operating company reorganization.[94]

[93] Such action has been taken in American's case with the express understanding that neither petitioners nor government counsel should regard the transactions as involving any waiver of objections to the orders under review, and we do not conceive that any waiver has occurred by either petitioner. In Appendix F to this brief we set forth the form of letter used to express this understanding with American.

[94] A phase of this reorganization was before this Court in *American Power & Light Co.* v. *Securities and Exchange Commission*, No. 470, 1944 Term, decided June 4, 1945.

Florida Power and Light Co., — S. E. C. — (1943), Holding Company Act Release No. 4791. American made a capital contribution to Florida consisting of $17,000,000 principal amount of debentures and preferred stock having approximately $4,400,000 of liquidating value, and permitted reduction of the stated value for the common stock by approximately $6,400,000. These steps by American made possible the elimination from Florida's plant account of approximately $30,000,000 of inflationary items and in turn enabled Florida to refinance its publicly held 5% bonds and 7% preferred stock with new 3½% bonds, 4⅛% debentures, and less-than-3% serial notes. Previously American's claims were at least in part subordinate to publicly held securities;[35] it emerged with sound securities in a company in which the annual interest and dividend claims on public holdings were reduced by over $1,400,000 per annum.[36] Furthermore, whereas prior to the transactions the possibility of sale or distribution of any part of American's holding in Florida would have been highly questionable, American emerged with a substantial

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[35] The Commission's findings indicate substantial basis for applying to American's debt claims the equitable principles applied by this court in *Taylor* v. *Standard Gas and Electric Company*, 306 U. S. 307.

[36] While larger income taxes permitted current realization of only $470,000, obviously this net savings does not represent the full benefit to American of the reduction in the claims of public bond and preferred stock holders.

common stock equity plus $5,000,000 of debenture, both readily susceptible of sale or distribution.

Another excellent example is the reorganization of United Gas Corporation, also consummated subsequent to the closing of the present record. *United Gas Corporation, et al.*, — S. E. C. — (1944), Holding Company Act Release No. 5271. Prior to the reorganization, United Gas had outstanding nearly $53,000,000 of 6% debt, $3,900,000 of 5% debt, and over $133,000,000 of 7% preferred stocks. There was a complicated problem as a result of the holding of the $53,000,000 debt claim by Bond and Share. Further there was a controversy as to the relative rank of public security holders and the system holdings as well as controversy between Bond and Share and Electric. In the reorganization the Bond and Share debt claim, plus $1,700,000 stated value of preferred stock, plus miscellaneous interests, held by Bond and Share were surrendered for a cash payment in the compromise amount of $44,000,000. Electric received common stock for its own holdings of preferred and common stock, and the public security holders of first preferred were paid their full redemption claim. A new 3% bond issue in the amount of $100,000,000 furnished cash to pay off the publicly held first preferred as well as the reduced Bond and Share debt claim.[97]

[97] As a matter of mechanics, cash passed from United Gas to Electric in return for preferred stocks and Electric effected the settlement of the Bond and Share claim.

In discussing the fairness of the plan to Electric, the Commission noted (assuming a 3¼% interest rate for the new bonds in lieu of the 3% rate obtained) that:

> * * * under United's present capital structure, the annual charges senior to the claims of Electric total $6,542,525 per year as compared with senior charges, under the proposed capital structure of United, of $3,250,000 per year. The resultant saving of $3,292,525 per year is a measure of the benefits accorded to United under the plan, which accrue principally to Electric's public security holders.[98]

The instances can be multiplied further, as in the case of the recapitalizations effected by American in three other subsidiaries, Texas Electric Service Company,[99] Texas Power & Light Company,[100] and Minnesota Power & Light Company.[101] In all of them, however, the pattern is substantially similar to the Florida transaction described

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[98] Holding Company Act Release No. 5271, at p. 31. This plan has been approved and enforced by a United States District Court. See *In re United Gas Corporation*, 58 F. Supp. 501 (D. Del.). Certain procedural problems with respect to review of this plan were recently before this Court in *Okin* v. *S. E. C.*, certiorari granted in part and denied in part, June 18, 1945, No. 1245, 1944 Term.

[99] — S. E. C. — (1945), Holding Company Act Release No. 5742.

[100] — S. E. C. — (1945), Holding Company Act Release No. 5797.

[101] — S. E. C. — (1945), Holding Company Act Release No. 5850.

above. Contributions of cash or securities by the holding company have permitted simplification of the corporate structures and substantial reduction of senior claims on income and have produced common stock equities of a character such as to be readily saleable to the public or distributable to holding company security holders.

Whatever course may be required to be pursued by a specific holding company, that course is measurably simplified by achievement of a portfolio of sound common stocks. Holding company senior securities may then be readily retired through distributions in kind, either voluntarily consummated or enforced by court order, or may be retired with cash obtained from public sale of such sound portfolio items. The process is, of course, no different whether pursued only to the extent necessary to simplify corporate structures in an integrated system where there is a genuine role for the holding company to play, or whether, as here, it is to be pursued to its logical conclusion of eliminating unnecessary, costly, and useless intermediary companies.

Following the clean-up of operating companies various alternatives are available to deal with the claims of the senior securities of the holding companies which are to be liquidated. Where cash is available from the proceeds of sales it may be applied in reduction of debt. Preferred stocks may also be retired in whole or in part by similar

cash payments. In some instances open market purchases have been used.[102] In other instances senior securities have been retired by voluntary exchange offers. Another possible method involves offering common stockholders the right to purchase common stock of a subsidiary which would otherwise be required to be disposed of, and using the proceeds of the offering to reduce or retire senior securities. Thus the current plan of Engineers Public Service Company to comply with the Commission's order requiring divestment of Gulf States Utilities Company, referred to at pp. 21–22 of our Engineers brief, involves permitting the common stockholders of Engineers to purchase from it the common stock of Gulf and using the proceeds to retire Engineers preferred.[103] A current plan to strengthen the structure of Pennsylvania Power and Light Company in the National Power and Light system, and thus facilitate the liquidation of National, involves offering National's common stockholders the right to subscribe to common stock of Pennsylvania in addition to that distributable to them in the liquidation of National. Bond and Share, as a stockholder of National, proposes to subscribe for its pro rata share. National proposes to subscribe for any of

[102] American has made open market purchases of its own bonds. See *infra*, pp. 120–121. A plan to retire the balance without a premium was disapproved as unfair under the circumstances. See *American Power & Light Company*, — S. E. C. — (Oct. 31, 1945).

[103] Holding Company Act Release No. 6131.

the offering not taken up by its common stockholders other than Bond and Share, and the Commission has approved the proposal.[104] Further possibilities include plans of exchange involving either individual securities or "packages" the acceptance of which becomes compulsory if approved by the Commission and enforced by a district court pursuant to Section 11 (e).[105]

Once the holding companies' capitalization is reduced to a single class of securities and the operating companies have been cleaned up, we have the relatively simple situation assumed above (p. 105) for illustrative purposes. Thereafter, as we pointed out, dissolution involves merely the removal of the unnecessary, costly, and useless intermediary company and the distribution of its assets to the persons entitled thereto. In some instances the process of reducing the successive claims of holding company security holders to the same rank and the distribution of the holding company's interest in subsidiaries can be telescoped into a single plan. An illustration is the plan of liquidation for United Light and Power Company which was before this Court in *Otis & Company* v. *Securities and Exchange Com-*

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[104] *National Power & Light Company*, — S. E. C. — (1945), Holding Company Act Release No. 6007.

[105] See the plan for Standard Gas and Electric Company, upheld by the Circuit Court of Appeals for the Third Circuit in *In re Standard Gas and Electric Company* (Sept. 14, 1945).

mission, 323 U. S. 624.[106] In view of the application of the "fair and equitable" standard as upheld by this Court in the United Light and Power case, security holders receive the same relative interests in the underlying assets, whether the Plan is one of direct liquidation or involves, first, simplification of the holding company structure to the point where its capitalization is represented by a single class of stock, and then distribution of the holding company's assets in liquidation.

Further illustration is afforded by the steps actually taken or contemplated by the three subholding companies of the Bond and Share system which have been ordered to be dissolved: National, American, and Electric.[107] Bond and Share's own description of the process is contained in a plan filed by it with the Commission on July 25, 1945. We quote its description of the steps taken under the Act by these three companies as of that date (pp. 7 and 8):

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[106] There had, however, been a number of preliminary steps in the course of which provision had been made for United Light & Power's first lien bonds and debentures. Thus the plan before this Court dealt only with the claims of preferred and common stocks.

[107] In explanation of National's not having appealed the dissolution order American suggests (Br. 21–22, n. **) that the problems confronting National were radically different from those confronting petitioners because of National's sale, prior to the dissolution order, of its properties in the T. V. A. area. However, the properties so sold comprised but 10% of the aggregate utility assets per books in the National system (using figures as of December 31, 1937, from Commission Exhibits 30a, 31a and 32a).

National Power & Light Company System

Following the entry of the order of the Commission dated August 23, 1941 * * * providing for the dissolution of National, the principles of a tentative plan to carry out the dissolution order were presented to the Commission on October 13, 1941.

In May 1942, a plan modifying and bringing down to date the tentative plan was filed with the Commission and subsequently has been further modified and amended. As a result of action taken under said plans and the prior retirement of the major portion of National's debt, the following principal steps have been accomplished by National and certain of its subsidiaries:

1. $24,500,000 of debt and $414,500 of assumed debt, and 279,716 shares of preferred stock of National have been retired. The preferred stock was retired in part through exchange for common stock of Houston Lighting & Power Company, a former subsidiary, and the balance through retirement at its liquidating value. Part of the funds for the retirement of the debt and preferred stock was obtained from the sale of National's investments in its Tennessee properties to the Tennessee Valley Authority and others, part from the sale of the portion of its holdings of common stock of Houston Lighting & Power Company not exchanged for preferred stock of National, and part from the sale of other investments.

2. A number of miscellaneous investments, including National's interests in West Tennessee Gas Company, have been disposed of.

3. Birmingham Electric Company has effected an adjustment of its accounts and capital structure, refunded its outstanding bonds after reducing the amount of its debt by $2,200,000, and has retired, or is in the process of retiring, an aggregate of 25,135 shares of its preferred stock.

4. Carolina Power & Light Company, having refunded its bonds in May 1940, effected an adjustment of its accounts and capital structure and subsequently exchanged its $7 and $6 preferred stocks for $5 preferred stock and reduced the amount outstanding by 10%.

5. Pennsylvania Power & Light Company, which refunded its debt in August 1939, is now engaged in effecting an adjustment of its accounts and capital structure.

As a result of these steps National now has only common stock outstanding and its major assets consist of the common stocks of Birmingham Electric Company, Carolina Power & Light Company and Pennsylvania Power & Light Company.

The Company is advised that plans for the completion of the dissolution of National and the settlement of certain claims * * * and a plan for the recapitalization and refinancing of Pennsylvania Power & Light Company are to be filed

with the Commission at the earliest practicable date.

[Since the date of this report, National has filed plans under Section 11 (e) providing for the settlement of intrasystem claims and for the final dissolution of National. Holding Company Act Release 6007. Also, Pennsylvania Power & Light Co., National, and Bond and Share have filed a joint plan for the reorganization of Pennsylvania, which plan has recently been approved by the Commission. *National Power & Light Co.*, — S. E. C. — (Oct. 26, 1945).

American Power & Light Company System

Operating companies of the American system have accomplished eleven refunding operations and fourteen reorganizations. Twenty properties have been sold to outside interests. Eight subsidiaries have been merged with other subsidiaries in American's system; six direct subsidiaries of American have been made subsidiaries of other subsidiaries of American; and five non-operating companies, subsidiaries of American's operating subsidiaries, have been disposed of to outside interests or the companies dissolved.

Of the twenty properties disposed of by American to outside interests, the largest were Nebraska Power Company, which was sold for approximately $14,421,000, and the oil properties of Glacier Production Company, which were sold for approximately $9,600,000.

American filed, in October 1942, an application for authority to purchase and retire $10,000,000 of its debt. Under the authorization thereupon granted, American purchased and retired $7,766,700 principal amount of Gold Debenture Bonds, 6% Series, and $776,700 of Gold Debenture Bonds, 6% Series, of Southwestern Power & Light Company assumed by American.

American also filed a plan with the Commission on July 13, 1944, pursuant to Section 11 (e) of the Act, under which it seeks approval to retire, at the principal amount plus interest to the date of retirement, $33,386,300 principal amount of its Gold Debenture Bonds, 6% Series, and $3,003,300 principal amount of Gold Debenture Bonds, 6% Series, of Southwestern Power & Light Company assumed by American, which together represent the entire outstanding long term debt of American. Hearings on the plan closed on November 9, 1944. No decision has yet been rendered by the Commission.[107a]

In addition to these steps, in November,

[107a] On October 31, 1945, the Commission issued its Findings and Opinion disapproving the plan, the Commission concluding that the fair and equitable standards of Section 11 (e) required that holders of American's debentures should receive 110% of principal amount plus accrued interest, and that holders of the Southwestern debentures (which are non-callable until 1947) should receive not less than 110% of principal amount plus accrued interest. American was given 30 days to file an amendment in accordance with the Commission's Findings and Opinion. An amendment designed to comply with this condition was filed on November 5, 1945.

1943, American filed a plan of recapitalization with the Commission which provides for a single class of capital stock. No disposition of this plan has been made, hearings having not yet been completed.[107b]

Electric Power & Light Corporation System

As a preliminary to the submission of a comprehensive plan for final compliance with the Act by Electric, five major operating subsidiaries have made accounting reorganizations and eight have successfully undertaken refunding operations. In further compliance with the Act, the common stock of Idaho Power Company was sold through public distribution, in 1943, for $10,361,250, and, in 1944, the transit portion of Utah Light and Traction Company was sold to outside interests for $675,000.

In addition, the reorganization under Section 11 (e) of the Act of United Gas Corporation (Electric's largest subsidiary) has been completed * * * On September 7, 1944, following hearings which were begun in 1941, United Gas Corporation's Plan of Reorganization was approved by the Commission. On November 21, 1944, it was approved by the United States District

[107b] American's application for recapitalization was consolidated for hearing with the proceedings under Sec. 11 (b) (2) for purposes of the determination of the appropriate allocation between preferred and common stock in any plan which might be proposed under Section 11 (d) to effectuate the dissolution order under review. Holding Company Act Release 4695.

Court for the District of Delaware. On November 28, 1944, the Plan was consummated. As a result of this Plan United Gas Corporation's capital structure was greatly simplified and now consists of $100,000,000 First Mortgage and Collateral Trust 3% Bonds, all publicly held, and 10,653,302.2 shares of common stock ($10 par value) of which 10,108,101 shares, or 94.9%, are owned by Electric.

On or about March 21, 1945 Utah Power & Light Company (Utah), a subsidiary of Electric, filed its application with the Commission for the approval of a Plan of Reorganization under Section 11 (e) of the Act, in which Electric joined. Such Plan provides, among other things, that Electric will surrender all of its holdings in Utah and will release Utah and its subsidiaries from all claims in favor of Electric against Utah and its subsidiaries, in consideration for which Utah will (a) pay Electric $650,000 in cash, (b) release Electric from all claims in favor of Utah or any of its subsidiaries against Electric and (c) assign to Electric all claims of Utah and its subsidiaries against the Company [Bond and Share] and its wholly owned subsidiaries. Hearings on this Plan have been completed, subject to call of the Trial Examiner, and a determination by the Commission is awaited.

As we have indicated in our North American brief (p. 88, 89, n. 45), disinterested financial commentators have agreed that (quite apart from any

considerations of public interest) the process of dissolution is one which adds value to the interests of holding company security holders.[108] In the instant case the Commission concluded, "it cannot be doubted that the dissolution of these companies which not only have never served any useful purpose but have been a medium of much harm, will effectuate the provisions and policies of the Act and will in all respects be beneficial to the public interest and the interest of investors and consumers; and we so find." (R. 636.)

3. *Suggested alternative types of orders.*—Two alternative substitute orders are suggested by, or implicit in, petitioners' criticism of the instant

[108] "The Outlook" for June 7, 1943 (publication of Standard and Poor's Corporation, vol. 15, No. 23, pp. 685–686), states:

"Holding company stocks have benefited from integration or liquidation plans filed with the S. E. C. in recent months. * * * Since utility holding company stocks normally sell at a discount from their liquidating value (just as do investment trust equities), the filing of liquidation plans has caused the prices of securities involved to advance sharply to approximately those values.

"This was the experience of the common stocks of Federal Water & Gas, National Power & Light, Niagara Hudson Power, and United Gas Improvement, all of which have lately filed integration plans, as well as the preferred stocks of Standard Gas & Electric and United Light & Power. Many of these issues more than doubled in price with the announcement that liquidation or integration of the holding company was planned. * * * additional utility holding companies will probably file integration of liquidation plans, which should prove beneficial generally to the market prices of their securities." For more recent comment, see note 124, page 146, *infra*.

orders. First, it is objected that the real offender against the statutory standards was Bond and Share—not petitioners[109]—and that therefore the Commission's order should be leveled at Bond and Share so as to require it to divest itself of its interest in petitioners. This argument of course proceeds from the false economic premise that dissolution of a useless holding company destroys something of value. Moreover, the alternative now put forward by petitioners would have given rise to at least some color of objection on the score of hardship. If the Commission had proposed to enter such an order, Bond and Share would doubtless have voiced objection to compliance on the ground that disposition of its interest in petitioners, as they and their subsidiaries were constituted at the time of the Commission's

[109] Petitioners' argument that they have been merely pawns of Bond and Share and should not be held responsible for its activities is not only based on the false premise that the remedy is punitive, but it is also pure ventriloquism in view of Bond and Share's complete domination of petitioners which enables it to speak through its own name or through petitioners in accordance with its ideas of litigation strategy. In this connection we note that these appeals were taken after both petitioners had advised their security holders they had no intention of appealing (see p. 22, *supra*); that Electric subsequently advised its security holders that the present appeal was being instituted at the request of Bond and Share; that American's petition for review was identical with Electric's and filed on the same day; that Bond and Share did not itself appeal; and that throughout this proceeding petitioners have been represented by counsel for Bond and Share and, indeed, were represented solely by such counsel until the closing days of the hearing before the Commission.

order, would necessarily have been at a sacrifice from the larger potential values realizable after clean up of the financial structures of petitioners and of the operating subsidiaries.

In any event, such an order would have been far more difficult than the instant orders to enforce in a manner consistent with the public interest and the interest of investors. One difficulty such enforcement would present would relate to appraising the value of Bond and Share's holdings of petitioners' common stock, either for purposes of a fair and equitable plan of distribution among its stockholders or for passing on a sale price. Thus in considering a program of Bond and Share to make market purchases of its preferred stock, the Commission pointed to the virtual impossibility of appraising the potential value of the preferred stockholders' claims. See *Electric Bond and Share Company*, 10 S. E. C. 1, 4–5.[110] While some of the complexities there involved related to other sub-holding companies, appraisal of Bond and Share's interests in the common stocks of petitioners would have been a substantial part of the

[110] It is noteworthy that the so-called plans filed by petitioners expressly disclaim any present attempt to suggest an allocation among existing stockholders of the new common stock which they propose to substitute for existing stocks. Electric's plan stated, "various factors make it impracticable at the present time to determine what would be a fair and equitable distribution" (R. 482). American's plan merely stated that the new common stock might be "allocated on an equitable basis to each class of stock" (R. 416). See also the explanation of its president (R. 273).

task which the Commission concluded to be so baffling. Persons acquiring Bond and Share's interest in petitioners would be acquiring an interest in companies which were themselves subject to the necessity for drastic reorganization, and with assets consisting of securities of subsidiaries also in need of reorganization. These complexities would have tended both to impair marketability and to impede fixing a fair basis for allocation.[111] Enforcement of the order would also have entailed the difficulty discussed below of providing a management for mere paper companies which had theretofore performed no genuine economic function. Moreover, such an order would have been wholly inadequate to cure the statutory evils found to exist in the American and Electric systems.

(b) Another alternative, which was considered and rejected by the Commission as implicit in the so-called Plans which petitioners filed at the close of the proceeding, involved the simplification of petitioners' capital structure to the point where they would not offend against the statutory standards, and limiting each of them to such integrated systems as might be retained consistently with the standards of Section 11 (b) (1). Petitioners made no suggestion, however, that any order re-

[111] In systems where complexities are of a different order, as where the operating subsidiaries were in a relatively sound financial condition, the Commission has found it feasible to deal with top holding company problems before touching the problems of the subsidiaries. *Cf. United Light & Power* case, *supra*, pp. 116–117.

quiring such action would be appropriate or permissible at the then state of the record.[112] Their plans moreover made no provision for the elimination of Bond and Share's control. The Commission concluded that, among other difficulties, this program was "too fraught with potentialities of delay to be acceptable as a substitute for a dissolution order to meet the problems existing under Section 11 (b) (2)" (R. 641). Here again the plans were incomplete for failure to provide for the elimination of petitioners as pyramiding instrumentalities and complexities within the Bond and Share system. Moreover, the Commission observed that American and Electric are undue and unnecessary complexities, "partly because they do not perform, nor have they ever performed, any useful function," and noted that nothing in petitioners' plans was calculated to impart a useful function to petitioners (R. 645).

[112] Indeed, the only respect in which this point may have been urged before the Commission is in connection with the respondent's suggestion that if a dissolution order should be entered it should contain a reservation to the effect that either of petitioners should have the right to apply for revocation or modification of the order on a showing of (a) removal from the Bond and Share system, (b) reduction of capital structure to a single class of stock, and (c) disposition of all properties and securities not retainable under Section 11 (b) (1) standards. The Commission rejected this suggestion as unnecessary and undesirable in view of the express provisions of the penultimate sentence of Section 11 (b) for revocation or modification in the event that "the conditions upon which the order was predicated do not exist" (R. 647–648). See also pp. 133–134, *infra*.

The Commission stated (R. 645):

> There is nothing about the subholding companies which makes them vehicles for holding together a single integrated system in any respect superior to any other corporate entity, and in fact it would seem that a company specially formed for this purpose, with appropriate domicile [113] and a charter and bylaws free from the complexities found in those of American and Electric, would be far preferable. More important it is not at all certain on the present record that either American or Electric possesses any "single integrated system" which requires a holding company to hold it together.[114]

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[113] Petitioners are both incorporated in Maine, a state in which neither has subsidiary operating companies. See p. 9, *supra*. One of the serious holding company abuses has been the difficulty confronting local regulatory authority in dealing with out-of-state holding companies. Report of National Power Policy Committee, House Doc. No. 137, 74th Cong., 1st Sess., pp. 7, 8. See also Sections 1 (a) (5) and 1 (b) (1). Thus, the exemption provided in Section 3 (a) (1) for predominantly intra-state systems is unavailable if the holding company is not incorporated in the state where the operating company conducts its utility business.

[114] Electric, in connection with its asserted "Southern System", states that it is "the only visible means of integrating" that system (Elec. Br., p. 23). However, visibility and an existing charter are not necessarily advantages for any purpose, as evidenced by the general practice of the Bond and Share system to create new corporate entities to meet particular situations as they arise. And as pointed out in the Commission's opinion (R. 645), Electric's visibility does not render it superior to an invisible corporation specifically incorporated to hold together a Southern system in con-

The reorganization of American and its limitation to a single integrated system raised such problems that American has admitted there is real possibility that it cannot continue to exist after such reorganization (R. 432).

While Electric claims to have a "Southern System", the Commission stated that there was a substantial question whether it could meet the standards of the Act. First, it was composed of gas properties and electric properties, which the Commission has held cannot be parts of a single integrated system, but are separate systems. The gas properties, largely those of United Gas Corporation, are located principally in Texas, while the electric properties are located principally in Louisiana, Mississippi and Arkansas (see the map in Electric's brief facing p. 62). A rough indication of the size of the properties involved may

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nection with the dissolution of Electric. Compare the creation of a Texas holding company to hold together the Texas properties of American, *infra*, n. 118. In any event, the Commission's choice as to the method by which progress is most likely to be made should not be defeated by an argument that in one possible eventuality it may be feasible to use an existing, rather than a new, corporation to carry out the desirable business functions permitted under the Act. Charters are cheap. Thus it was recognized by American's president in connection with the contention that American's controlled companies should be continued in a group that those companies might constitute four integrated systems, "irrespective of whether they are retained by American in any particular instance" (R. 276). American's plan contemplated organizing 3 new holding companies to maintain unified control of subsidiaries to be divested by it (R. 401).

be obtained from referring to gross book assets of the subsidiaries in question. See Appendix F-2 to the findings (R. 667). The assets of United Gas Corporation were over $309,000,000 (using the unadjusted figures in Column 1). The electric utilities subsidiaries were Arkansas Power & Light Co., with over $76,000,000 of book assets; Louisiana Power & Light Co., $42,000,000; Mississippi Power & Light Co., $38,000,000; New Orleans Public Service Co., $80,000,000.[115] It was also doubtful, in the light of the size of the electric and the gas systems, whether they might both be retained by the same holding company under the standards for retention of additional systems.[116] The electric properties of the so-called "Southern System" taken by themselves presented serious problems as to whether in fact they are not "so large as to impair * * * the advantages of localized management, efficient operation, and the effectiveness of regulation" and, therefore, are not a single integrated system within the definition of Section 2 (a) (29). Even

[115] Dallas Power & Light Co., with $38,000,000 of book assets, is included in the map, Appendix C to Electric's brief, as part of its "Southern System." However, Electric's plan recognized that divestment might be required (R. 502), and the Commission has since approved its sale to American for inclusion in the Texas system referred to in note 118, *infra*.

[116] Although Electric appears to argue now solely on the basis of its electric system (See Elec. Br., p. 24), careful reading of its brief indicates that it has not abandoned its contention that the United Gas properties may be retained with these electric properties.

if the southern properties could be held to meet the Section 11 (b) (1) standards, there was further substantial doubt that Electric had sufficient investment in them to be permitted to serve as an agency to keep them together (R. 646). Since the Commission did not pass upon these questions, it was not inconceivable, at least in the case of Electric, that petitioners might ultimately be transformed into appropriate corporate vehicles for holding under common control integrated public utility systems.

Whatever the possibility of this result being achieved through voluntary action by petitioners, it was hardly a program for the Commission to order pursuant to Section 11 (b). Such an order would have required a sweeping change in the facts confronting the Commission. Moreover, such a program would be fraught with difficulties of enforcement through a court-appointed trustee in the event of non-compliance by petitioners, since it would involve, among other things, endowing with actual function and management paper corporations which had never theretofore performed any useful function. In addition to changing the capitalization and assets of petitioners to the point where there would remain scarcely a semblance of the existing entities, carrying out such an order would have been an act of promotion of a new holding company enterprise rather than a mere reorganization. To have the Commission and the enforcement court undertake such a function is

scarcely consistent with the declared policy of the Act to "provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title."[117]

Nevertheless, in discussing the form of its order the Commission made it clear that if, through changes brought about by petitioners, or the Bond and Share management, petitioners could be transformed into holding companies which served the

[117] American (Br. pp. 106–107) argues that the Commission has applied an inconsistent remedy in a substantially identical case, citing *The United Corporation*, — S. E. C. — (1943), Holding Company Act Release No. 4478. That case presented an entirely different situation, as appears from the discussion in the Commission's opinion of the reasons why it felt it proper not to issue a dissolution order. United was afforded an opportunity to become an investment company. It was clear there that, since United, unlike petitioners, was a top holding company with a management of its own, its disposal of the securities of its subsidiaries and its elimination from control over them would remove it from the scope of the Act. Unlike United neither of petitioners has indicated any desire to become an investment company; in this case, the suggestion of petitioners is to the effect that they should be permitted to remain holding companies, a course which the Commission properly regarded as not a desirable one. But the Commission has not insisted on dissolution to meet all the problems presented by the subholding companies in the Bond and Share system. Thus no suggestion has been made that petitioners' sister company, American Gas, be dissolved since it appears that unlike petitioners, that company has a management of its own and can serve as a means of tying together a single integrated system. See the Commission's tentative findings and conclusions in *American Gas and Electric Company*, — S. E. C. — (1945), Holding Company Act Release No. 5591.

function of tying together properties satisfying the standards of Section 11 (b) (1) and needing a parent holding company, and if it appeared that either of petitioners would be an appropriate corporate vehicle for such purpose, then there would be room for modification of its orders under the express provisions of Section 11 (b) applicable in the event of change of circumstance (R. 647–648). Even if modification of the dissolution orders is not taken into account, there was nothing to prevent carrying out the orders through transfer to newly organized holding companies of such operating company stocks owned by petitioners as may properly be controlled by holding companies—a possibility suggested in both petitioners' plans (R. 400–401, 432, par. 59; 503, fourth paragraph) and which the Commission has subsequently approved on application of American.[118] Thus apart from the fact that the Commission's orders required action while petitioners' proposals promised only delay for an indeterminable period, the difference between the end results could amount at most to the difference between using an existing corporate vehicle or creating a new one.

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[118] American is acquiring Dallas Power & Light from Electric and putting it in a new holding company incorporated in Texas together with two of its own Texas subsidiaries, Texas Electric Service Co. and Texas Power & Light Company. The new holding company is to be divested by American, — S. E. C. — (Oct. 26, 1945).

Electric argues that the statute gives every holding company a right to hold a single integrated system and that the Commission can enter no order which does not continue a holding company's existence for this purpose. This misconceives the statute. Section 11 (b) (1) and Section 11 (b) (2) though related contain independent directions from the Congress. No holding company can continue to exist unless it meets the standards of both clauses. Of course a holding company simple in structure, which has truly functioning officials and a substantial stake in an integrated utility system, may retain that system. This, as we have noted, is contemplated by the Commission's tentative conclusions applicable to petitioner's sister company, American Gas and Electric Company. But this assumes that the holding-company system in question does not violate Section 11 (b) (2). On the other hand a complex series of holding companies over a single system cannot continue to exist; it must be scaled down by the elimination of all unnecessary holding companies. Of course the Act is designed to promote the economies obtained from integration of utility properties, and any single integrated system will not be broken up under the Act. But the Act is not concerned with preserving holding companies which cause unnecessary complexity in the system. In that simplification process there is nothing which requires an endeavor to preserve particular corporate entities as possible vehicles for hold-

ing together such properties in the holding company system as may properly survive as parts of a single system. The process of simplification may well result in the elimination of all existing holding companies in a system because a new company is more suitable for the purpose of holding the system together than any of the existing holding companies.

Petitioner's contention that the Commission must try to find an integrated system or combination thereof for each existing holding company in a holding company system is only another way of arguing that dissolution of a useless holding company is never permissible. Assuming, what was not questioned before the Commission and what is demonstrated in point IV, that dissolution is a method of simplification of holding companies clearly contemplated by the Act, the question narrows to one of the appropriateness of the remedy in this particular case. We have shown that the Commission's choice of that remedy was a rational one, designed to ensure compliance and highly salutary in its effect on the investors in petitioners.

4. *Petitioners' Plans are no bar to dissolution.*—Petitioners contend that no order of dissolution should have been entered without disposing of their plans and seeing whether those plans afforded an opportunity of preserving petitioners as holding companies. The possibility that either of petitioners could eventually conform to the

statute in this manner was, as we have seen, no bar to the entry of an order of dissolution. The argument is no more effective as a bar to the entry of an order because presented in the form of a "plan," particularly a vague and general plan with no present possibility of bringing the petitioners into compliance with the Act.

As we have seen, the Congress has imposed upon the Commission the duty to declare, by order, as soon as practicable, what each holding company system requires by way of integration and simplification. Section 11 (e), to be sure, provides an opportunity to holding company managements to anticipate Commission action under 11 (b)—or to comply with Commission orders thereunder—but, if petitioners' argument is accepted, it would provide an opportunity also for such managements effectively to stay the Commission's hand indefinitely by the simple device of proposing "plans", however inadequate, which purported to meet the issues tendered by the Commission in a proceeding under Section 11 (b).

Petitioners' argument is that they have a right to a hearing on the plans before a dissolution order is entered.[119] Presumably this rests on the theory

[119] Electric complains that its motion for consolidation was not denied until eight and one-half months after it was made (Elec. Br. p. 21). The record shows, however, that any delay in consideration of the motion was "pursuant to a mutual understanding," confirmed in a letter from J. F. MacLane, one of petitioners' counsel, to Commission counsel. (R. 233, Resp. Ex. 328).

that not until a hearing has been held can the Commission decide whether the plans have some effect on the need for dissolution. But the Commission is not required to blind itself to the obvious. A mere reading of the plans showed they in no way gave promise of eliminating the need for dissolution. The Commission's opinion (R. 639–647) points out in detail the deficiencies on the face of the plans.

It was pointed out that the provisions for recapitalization were vague and ineffective because they gave no details of a proposed new capital structure and made no specific provision for retirement of debt. (R. 642–643.) Electric's plan stated that "various factors make it impracticable at the present time to determine what would be a fair and equitable distribution" (R. 482), and American's plan stated that new securities might be "allocated on an equitable basis" (R. 416). American's president testified that to propose an allocation might focus attention on that matter "and controversy would arise with respect to it and detract from the merits of the plan as a whole" (R. 273). With regard to limitation to a single system, American chose no system and neither petitioner gave any specific indication of how such limitation was to be effected (R. 642, 643). For American's reasons for not being specific see R. 272. It was further pointed out that the plans would be ineffective because they did nothing about eliminating Bond and Share's

control over petitioners and removing the pyramiding character of petitioners; because the plans contained no provision for imparting a useful function to petitioners; because the plans gave no assurance that petitioners would have sufficient interest in any integrated utility system to serve as a means of holding it together; and finally because even if approved the plans could become effective only on approval of stockholders.[120] It seems clear that the Commission properly determined that there was no basis for concluding that "by virtue of these documents the dissolution of American and Electric is not 'necessary' within the statutory meaning" (R. 647).

Petitioners do urge that the Commission could have approved the plans subject to amendment (Amer. Br. 105). But the Commission has no power to *compel* an amendment of a Section 11 (e) plan, and the Commission was not required to expect reasonable amendments from companies whose plans were so completely defective. Indeed in the light of the evidence that the plans had been prepared and put forward only for purposes of delay (R. 636–638, 640, 641), the Commission would have been little less than naive if it proceeded on the assumption that satisfactory voluntary amendments to the plans would be forthcoming either before or after hearings.

[120] In the case of American's plan, approval of 90% of each of the company's two series of preferred stock was required in addition to majority vote of the common stock (R. 465).

Of course petitioners are entitled to have their plans acted on at an appropriate time, but they have not pressed these plans except as a strategic argument against dissolution. If they were to be acted on, the Commission has indicated that the proper course would be dismissal (R. 643). Indeed these plans have never had real substance except for the purposes of this litigation. As we have noted, *supra,* pp. 110–114, 120–123, many plans filed subsequently by petitioners have been approved and carried out because, unlike the present plans, they were specific and contained promise of assisting achievement of the statutory objectives. No point would have been served by consolidating the plans with the present proceeding and thus devoting to these plans the time and energy of Commission staff and company management which were in fact profitably devoted to consideration of the many other more limited proposals which have been consummated and have carried petitioners far along the road to compliance. Cf. *F. C. C.* v. *Pottsville Broadcasting Co.,* 309 U. S. 134, 143; *Brendle* v. *Smith,* 46 F. Supp. 522 (S. D. N. Y.).

III

SECTION 11 (b) OF THE ACT IS CONSTITUTIONAL

(a) *Interstate Commerce*

In our *North American* and *Engineers* briefs, we have analyzed the structure of the Public Utility Holding Company Act and have shown

how the integration and simplification provisions contained in Section 11 are designed to apply only to the typical interstate holding company. That the Court need not concern itself in this case with the possibility that, as applied to some other company, the Act might be too broad, is apparent not only from the analysis of the statute contained in the other briefs but also from the showing which has been made above. The Bond and Share system, and those of the petitioners themselves, are typical interstate holding company systems.

Indeed, petitioners have no local functions. They are exclusively instrumentalities of interstate commerce and interstate control. Incorporated in Maine, they serve as formal conduits whereby Bond and Share, from its offices in New York City, is enabled to direct and control every aspect of its nation-wide system of utility operating companies. They were promoted by Bond and Share as vehicles for nation-wide distribution of securities. It is these petitioners of whom this Court stated, on the basis of facts incorporated in the present record,[121] that their "continuous and extensive operations in [interstate] commerce" brought them within the ambit of Congressional authority. *Electric Bond and Share Co.* v. *S. E. C.*, 303 U. S. 419, 431–33, 440. The Bond and Share system, as indicated above, is a giant pyra-

[121] Comm. Ex. 68a–f.

mid consisting of Bond and Share, five subholding companies including the petitioners, and approximately 237 direct and indirect subsidiaries with consolidated capitalization and book assets approximating $3,000,000,000 and supplying electricity or gas to more than 2,300 communities in the United States having a total population of some 12,000,000 and located in 32 States and to over 1,000 communities in foreign countries. The analysis which has been made in Points I and II indicates the vast interstate implications of the systems involved and the great complexities and inequities present in those systems.

The complexities and inequities in the Bond and Share system are typical of the practices with which Congress was concerned when it declared the purpose of the Act to deal with the "evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce * * *" (Section 1 (c)). Congress declared that those evils, as set forth in Section 1 (b), adversely affected "the national public interest, the interest of investors in the securities of holding companies and their subsidiary companies and affiliates, and the interest of consumers of electric energy and natural and manufactured gas * * *." In our *North American* brief we have shown in detail how complex and overcap-

italized structures marked by pyramiding and leverage presented great hazards to investors in the securities of holding companies and their subsidiaries and also to consumers of their product. See, e. g., our *North American* brief, pp. 37–44, 55, 56, 71–74. There we pointed out by reference to the report of the Federal Trade Commission and of the National Power Policy Committee the great dangers to investors resulting from leverage securities which might quickly rise in value and just as quickly fall; that holding companies by reason of the leverage of their securities make of a relatively stable public utility enterprise a means of stock speculation and gambling, and that they create unsound capital structures resulting in pressure on operating companies to sustain the excessive capitalization to the detriment of their service to consumers as well as consequent resistance to reduction of rates. These evils are promoted by, and directly affect, the interstate commerce in which the holding companies engage, and Congress was clearly justified in exercising its commerce power to eliminate those abuses and effects. Indeed, this Court has recognized that the correction of the financial structure of a public utility enterprise bears a vital relation to the interstate commerce in which the enterprise is engaged or which it affects, a fact as true in the case of a typical interstate public utility holding company as in the case of an interstate railroad. See *Ecker* v.

Western Pacific Railroad Corp., 318 U. S. 448, 474:

> The reasonable earning power of securities, the terms and conditions of the respective issues, and the soundness of the aggregate capitalization affect the public interest immediately and directly. Capitalization is an essential factor bearing on an efficient transportation system for shipper, investor and consumer.

No difference can be shown between the present case and the *North American* and *Engineers* cases. From a constitutional standpoint, with a view to both interstate commerce and due process, there is no distinction between the remedies provided by Section 11 (b) (1) and by 11 (b) (2). Both deal with complexity in holding company systems; both direct simplification. They approach the problem of simplification by somewhat different methods; Section 11 (b) (1) by outlawing geographical dispersion of properties and Section 11 (b) (2) by attacking financial complexities and inequitable distribution of voting power in the system. The choice of two separate means to a proper end when both are clearly appropriate to that end creates no constitutional problem.

(b) *Due Process*

Most of petitioners' arguments as to due process have been answered in our *North American* brief. Indeed, some of those arguments were advanced by petitioners then appearing as *amici*

curiae. The only point now made not previously adverted to is the argument that the due process clause prohibits subjecting petitioners to "compulsory involuntary reorganization," a process asserted to be possible only under the bankruptcy power. It is thus asserted that no power exists under the commerce clause to dissolve a state corporation, to reorganize it, or presumably to alter in any way the powers granted it by the state. To prove the fallacy of this argument it is necessary only to refer to the anti-trust cases requiring reorganization or liquidation of solvent companies. *United States* v. *Reading Co.*, 253 U. S. 26; *Northern Securities Co.* v. *United States*, 193 U. S. 197.[122]

[122] We quote from the opinion in *Northern Securities Co.* v. *United States*, 193 U. S. 197, 344-45 (1904), describing this argument:

"In other words, if the State of New Jersey gives a charter to a corporation, and even if the obtaining of such charter is in fact pursuant to a *combination* under which it becomes the holder of the stocks of shareholders in two competing, parallel railroad companies engaged in interstate commerce in other States, whereby competition between the respective roads of those companies is to be destroyed and the enormous commerce carried on over them restrained by suppressing competition, Congress must stay its hands and allow such restraint to continue to the detriment of the public because, forsooth, the corporations concerned or some of them are state corporations. We cannot conceive how it is possible for any one to seriously contend for such a proposition. It means nothing less than that Congress, in regulating interstate commerce, must act in subordination to the will of the States when exerting their power to create corporations. No such view can be entertained for a moment."

Since great emphasis is placed in American's brief (pp. 35–40, 85–88) on the contention that the statute is retroactive and *ex post facto,* we reiterate that Section 11 is remedial and imposes no penalty for past acts—it is merely a direction that a previously existing relationship be terminated for the future in order to protect the public interest. It is clear from the cases under the Antitrust and Hepburn Acts that such a regulation is not subject to constitutional attack as retroactive or *ex post facto.* See *United States* v. *Trans-Missouri Freight Assn.,* 166 U. S. 290, 342; *United States* v. *Delaware & Hudson Co.,* 213 U. S. 366.[123]

Finally, despite the constant assertions that the orders in question will destroy property (*e. g.,* Am. Br., pp. 25, 38, 42–43) and the extravagant analogies between the effect of these orders and the taking of human life (Elec. Br., p. 38, Am. Br., p. 36), there is no more basis for assuming that compliance with the orders will have an adverse effect on values than there is in the case of the orders involved in the North American and Engineers cases.[124]

[123] American's attempts to distinguish these cases (Amer. Br., p. 37, n. ** carrying over to p. 39) assume that Section 11 is different because it is a penal and retroactive statute, an assumption which as we have seen is unfounded. The parallel between the present orders and the regulations involved in the cited cases is exact.

[124] See pp. 102–124, *supra.* Further, as of September 3, 1945, the Outlook (Vol. 17, No. 36, section 1, page 602) stated with reference to American Power and Light that "All the

(c) *Delegation of Power*

Petitioners argue (Amer. Br. 60–85) that the Act contains inadequate standards to guide the Commission in determining when the "corporate structure or continued existence of any company in the holding-company system does * * * unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system"; and they also complain that no standards have been developed or announced by the Commission which justify its action in this case. Apparently petitioners' contention is that

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issues should be worth materially more than current prices in any final settlement of this complicated situation, whether from the standpoint of all the present properties or whether the northern units are disposed of and only the southwestern companies are retained."

In the present case, as in the *North American* and *Engineers* cases, estimated liquidating values of the common stock, as computed and reported by Outlook, compare favorably with market values. This is exceptional in view of the extreme complexity and leverage position which add a speculative advantage to the common stock which is reflected in the market prices. Nevertheless, Outlook reports as of September 24, 1945 (Volume 17, No. 39, page 566) a liquidating value of $8.50 for American Power & Light common as compared to a market price of $7¾. Electric Power & Light common shows a liquidating value of $12.90 and a market price of $13. Of course the preferred stocks' liquidating values far exceed their present market prices. At some times in the past when the common stocks were under water and before the occurrence of improved conditions and improved financial policies in conformity with the Act, those stocks of course had a market price reflecting the speculative possibilities resulting from their leverage position.

either Congress or the Commission should have reduced the problem of simplifying complex holding company structures or removing unfairness in voting power to rules of thumb similar to the so-called "great grandfather clause" of Section 1 (b) (2) under which the Commission has no discretion to permit the continuation of more than two tiers of holding companies over any one operating company. Obviously there is a practical difference between fixing by such a rule of thumb the extreme limit of piling one holding company upon another,[125] and determining by mechanical formulae just when a particular holding company structure contains undue or unnecessary complexity.

Standards requiring the elimination of undue and unnecesary complexity and inequitable distribution of voting power, both by themselves and in the defined scope and expressed purposes of the Holding Company Act, afford far more definitely ascertainable criteria than the standard

[125] A situation where a three-tier holding company system might not involve undue or unnecessary complexity is where a holding company is necessary to maintain common control over two or more operating companies which are parts of a single integrated system but operate in more than one State, and where one of the operating companies has a relatively small subsidiary which there is some practical reason to keep as a separate corporation but where no significant pyramiding is involved. In some instances the subsidiary of the subsidiary might be a generating company separately incorporated to facilitate joint control with an operating company in another holding company system.

of public interest which this Court has found a sufficient guide to the Interstate Commerce Commission in passing on consolidations under the Transportation Act, 1920. See *New York Central Securities Corp.* v. *United States,* 287 U. S. 12, at 24–25, where it is stated "that the term 'public interest' as thus used is not a concept without ascertainable criteria, but has direct relation to adequacy of transportation service, to its essential conditions of economy and efficiency, and to appropriate provision and best use of transportation facilities, questions to which the Interstate Commerce Commission has constantly addressed itself in the exercise of the authority conferred. So far as constitutional delegation of authority is concerned, the question is not essentially different from that which is raised by provisions with respect to reasonableness of rates, to discrimination, and to the issue of certificates of public convenience and necessity * * *".

While the Securities and Exchange Commission, unlike the Interstate Commerce Commission, is a relatively new administrative agency, the background of evils revealed in the legislative studies, the express recital of evils in Section 1 of the Act, the standards for new security issues laid down in Section 7, the conditions for acquisitions of properties and securities prescribed in Section 10, the nature of the inquiry envisioned by Section 11 (a), and indeed the background of other federal regulatory legislation, including the

Interstate Commerce Act, all tend to illuminate the standards in the Act itself. Compare also the requirements of Section 77B (f) and Chapter X, section 174, of the Bankruptcy Act that a plan must be "feasible", and the broad discretion which Section 77 (d) of the Bankruptcy Act gives the Interstate Commerce Commission in determining whether the financial structure of a reorganized railroad is "compatible with the public interest." See *Ecker* v. *Western Pacific R. R. Corp.*, 318 U. S. 448, 473.

Petitioners' complaint of undue delegation seems disingenuous in view of the legislative history. As the Act proceeded through the Committees and the two Houses of Congress there was consistent objection by utility representatives that the hands of the Commission were being tied too tightly and not enough discretion was allowed.[126] That indeed was the view of the then President of Bond and Share, who objected to the original bill as putting the companies "in a straight-jacket," and he went so far as to advise the House Committee "to state general objectives and not a specific method, because conditions change so frequently." In fact, with regard to his recommen-

[126] See, for example, Statement of Wendell L. Willkie, Hearings before the Committee on Interstate Commerce, United States Senate, Seventy-fourth Congress, First Session, on S. 1725, p. 598; Statement of Henry L. Harriman, Hearings before the Committee on Interstate and Foreign Commerce, House of Representatives, 74th Congress, 1st Session, on H. R. 5423, Part II, p. 1559.

dation for the elimination of intermediate companies, he could suggest no standard more definite than "the public interest." [127]

[127] See the testimony of S. R. Inch, president of Bond and Share, as follows:

"Mr. LEA (interposing). Well, would you be willing to leave to the regulatory body the question of whether or not an intermediate holding corporation should be permitted to continue?

"Mr. INCH. Yes; I would. I would be willing to leave anything to a regulatory authority from whose decision there is a proper appeal allowed. I do not think that any commission of five men, let us say, who must necessarily be tremendously busy with a great many other things than that, should be given the power of life and death, with no appeal, and this bill provides for no appeal; there is no appeal from the facts as found by the commission.

"Mr. LEA. Now, if we leave that to the commission, or the regulatory body, of course, there are a good many things to be determined.

"Mr. INCH. Yes.

"Mr. LEA. The question of whether or not an intermediate company is to be removed would involve several things. What kind of procedure do you think should be provided to take care of that situation?

"Mr. INCH. *I would think, Mr. Lea, first of all that there should be some affirmative showing that the public interest is going to be served by its removal.*

"Mr. LEA. *You would be willing to leave that to the regulatory body?*

"Mr. INCH. *If its decision were subject to a reasonable review; yes.*

"Mr. LEA. Well, what kind of a yardstick would you give to the commission to determine just what kind of a company should be permitted to exist?

"Mr. INCH. *I should think you would not attempt, as this bill does, to put that in a straight-jacket, because con-*

Nor is there any substance to the complaint that the Commission has applied the statutory standards as prescribed by Congress on a case-by-case basis rather than by imposing rules of thumb which would be less flexible in their application. Cf. *Pittsburgh Plate Glass Co.* v. *N. L. R. B.*, 313 U. S. 146, 165–166. The most likely consequence of a rule of thumb would be to serve as a focus for arguments that the more particular standard was arbitrary and unreasonable just because it lacked flexibility. Cf. *National Broadcasting Co.* v. *United States*, 319 U. S. 190, 224–225.

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ditions change so fast, and I would suggest that the wise thing to do would be to state general objectives and not a specific method, because conditions change so frequently.

"Mr. LEA. Then, you would give authority to the regulatory body to determine what company was to continue, and what would be the fact, or what would be the reason upon which they should discriminate as between the one that is to continue and the one that is to be removed; that is one of the things they would have to do.

"Mr. INCH. Yes.

"Mr. LEA. Now, have you anything in mind, any particular standard or rule that should be set up to govern the determination of the commission?

"Mr. INCH. *Well, I can think of nothing, Mr. Lea, beyond the matter that they are dealing with a public question.*" (Hearings before the Committee on Interstate and Foreign Commerce, House of Representatives, 74th Congress, 1st Session, on H. R. 5423, Part 2, p. 1216; see also *id.* at 1220.)

IV

THE COURT BELOW PROPERLY REFUSED TO CONSIDER CONTENTIONS NOT ADVANCED BEFORE THE COMMISSION AND IN ANY EVENT THESE CONTENTIONS HAVE NO MERIT

A. *The Contentions Are Not Properly Before the Court*

Section 24 (a) of the Act provides that:

> No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission or unless there were reasonable grounds for failure so to do.

On the basis of this provision the court below properly refused to consider the following arguments made by petitioners which were not raised before the Commission (R. 875–876):

(a) "that § 11 (b) (2) does not as a matter of statutory interpretation authorize the dissolution of subholding companies as one method of bringing a holding company system into compliance with that subsection";

(b) "that petitioners are legally incapable of complying with the order of dissolution because dissolution can be effectuated only by a vote of the stockholders in pursuance of procedure prescribed by state law";

(c) "that the orders are not in accordance with § 11 (b) (2) in that they fail to prescribe the 'steps' which petitioners must take to effectuate compliance with the statutory requirements"; and

(d) "that the orders operate in effect to deprive petitioners of the benefit of the one-year period

granted by § 11 (c) within which to comply with the orders".

Petitioners presently press only the first of these contentions. They argue that the point was in fact raised by reference to an amended answer filed in 1940 (Am. Br. p. 108). However, the vague and general language referred to is in striking contrast to the treatment given the contentions actually raised, for all such contentions are dealt with in the Commission's opinion and petitioners stated in their petitions for rehearing that all their contentions "have been fully stated in the record and are dealt with by the Commission in its said findings and opinion" (R. 673–677).[128]

Petitioners seek to avoid the application of the requirement of Section 24 (a) by contending that there was reasonable ground for their failure to raise the foregoing contentions before the Commission because the Commission "had already uniformly held that it did have power to dissolve corporations" under 11 (b) (2) (Amer. Br. 109).[129]

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[128] See also the similar statements in the stipulation waiving filings of requests for findings, etc. (R. 520–522). In the Circuit Court of Appeals petitioners did not dispute the Commission's statement that they had not raised this question before the Commission.

[129] It should be noted that petitioners did urge before the Commission questions as to the constitutionality of Section 11 (b) (2) (R. 346–348, 355–356), although the Commission had frequently announced that it would not pass upon objections involving the constitutionality of the statutes it administers. See cases cited in *North American Company*, 11 S. E. C. 194, 198.

But Section 24 (a) will not serve its obvious purpose of requiring exhaustion of administration remedies unless the Commission is given the opportunity to reconsider its own precedents when there is objection to them, and also to determine whether even without such reconsideration it may be appropriate to eliminate a particular controversial issue from a case in the interest of avoiding litigation.

We include here a discussion of the contention upon which the court below refused to pass so that if this Court should conclude that the scope of review has been unduly limited it will be in a position to consider the merits of this contention—a course we believe is preferable to a remand to the court below, in view of the express Congressional desire that Section 11 (b) of the Act be effectuated as soon as practicable and in view of the "considerable period" already covered by this litigation. Cf. *Boston and Maine R. R.* v. *Gokey,* 210 U. S. 155, 162. See also *Dismuke* v. *United States,* 297 U. S. 167, 173; *Cole* v. *Ralph,* 252 U. S. 286, 289–290. To remand the case for consideration of these issues by the circuit court of appeals would not only unduly protract this litigation, it would doubly defeat the purpose of Section 24 (a), for petitioners would not only be able to withhold their arguments from the Commission, but in addition would further delay enforcement of the Act by having their appellate

review broken up into a multiplicity of stages. Such a course would moreover encourage a deliberate withholding of points for purposes of delay. Accordingly, we urge that if the Court is of the opinion that any of the contentions not passed on by the court below are properly subject to review, this Court should hear such arguments on the merits and decide them without a remand.

B. *Dissolution of Holding Companies Is Authorized By Section 11 (b) (2)*[130]

Section 11 (b) (2) provides that the Commission shall require each registered holding company to "take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or un-

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[130] Not only have petitioners failed to raise this point before the Commission but they have previously taken a position inconsistent with their present contention. Petitioners and Bond and Share in their brief before this Court in *Electric Bond and Share Company* v. *Securities and Exchange Commission*, 303 U. S. 419, referred to Section 11 as the "widely advertised *death sentence*" and as the provision relating "to the reorganization or *dissolution* of holding company systems" and they stated that "the Act directs the Commission to require all the major holding company defendants (with the possible exception of American Gas) to reorganize or *dissolve*" (pp. 34, 47 and 110; italics supplied). Similarly, as we pointed out at p. 37, *supra*, in their answer filed in that suit, these petitioners stated that enforcement of the Act would "leave them with no alternative but to dissolve." Com. Ex. 69, Vol. I, p. 177.

necessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding company system." Petitioners contend that the phrase "in the holding-company system" limits the authority of the Commission to orders removing a particular company from the holding company system of which it is a part, and does not permit an order terminating its existence. The plain intent of the statute precludes petitioners' construction.

It is clear not only from the first sentence of Section 11 (b) (2), quoted above, but also from other provisions of the statute that Congress gave the Commission "power to compel the elimination of holding companies deemed uneconomic." See *Otis & Co.* v. *Securities and Exchange Commission,* 323 U. S. 624, 637. Section 1 (c) declares it to be the policy of the Act, "in accordance with which policy all the provisions of this title shall be interpreted, * * * to provide as soon as practicable for the *elimination* of public-utility holding companies except as otherwise expressly provided in this title" [italics supplied]—that is, except insofar as the continued existence of a particular holding company will not violate the standards of Section 11 (b). The last sentence of Section 11 (b) (2) provides: "Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall author-

ize the Commission to require any *change* in the corporate structure or *existence* of any company which is not a holding company * * *" [italics supplied], an unnecessary provision if the subsection did not authorize changes in the existence of constituent companies in the holding company system. Thus, when the Commission finds that the structure of a holding company system is unduly complicated by the "continued existence" of one of the constituent companies, or that voting power is unfairly and inequitably distributed among the security holders of the holding company system by reason of the "continued existence" of that company, an appropriate if not the only method to "ensure" compliance with the statutory standards is by requiring that such company cease to exist.

Moreover, an examination of the grammatical structure of the first sentence of Section 11 (b) shows the error of petitioners' construction. It is apparent, from the entire clause "corporate structure or continued existence of any company in the holding-company system", that the phrase "in the holding-company system" necessarily bears the same function with reference to "corporate structure" as it does with "continued existence". Since this phrase obviously cannot modify "corporate structure" it cannot modify "continued existence", as petitioners claim, but

serves merely to modify and identify the word "company." [131]

The legislative history relied on by petitioners to bolster their position actually supports the contrary interpretation required by the face of the statute. Petitioners argue that, since the earlier drafts of the Senate bill (S. 2796) specifically provided that the Commission could require holding companies and their subsidiaries "to be reorganized or dissolved," and since in conference

[131] The words "any company in the holding-company system" were simply substituted for the words "such company" in an earlier draft of the section. See Section 11 (b) (2) of S. 2796, referred to in Amer. Br. pp. 110–111, note *. The fact that the substitute was not specifically adverted to in the conference report on the bill as passed (H. Rep. No. 1903, 74th Cong., 1st sess., 1935) indicates that no change of substance was intended. See *Jersey Central Power and Light Company* v. *Federal Power Commission*, 319 U. S. 61, 76, 77.

Moreover, the last sentence in Section 11 (b) (2) limiting the Commission's power to require "any change in the corporate structure or existence of any company which is not a holding company * * *" does not contain the phrase "in the holding-company system."

Petitioners make a similar contention with respect to the word "elimination" used in Section 1 (c) (Amer. Br. 111–112). The word "elimination" may carry the connotation of removal or dissolution according to its context. The context in which it is used in Section 1 (c) makes it clear that it was intended to mean "dissolution." In the same section, when the reference is to the disposition of "properties detrimental to the proper functioning" of the systems, the language is "to compel * * * the elimination *therefrom* [from the systems]." But, in providing for "elimination" of holding companies, the words indicating separation rather than dissolution are significantly absent.

this provision was changed to its present form, the Congress intended to withdraw the Commission's power to require dissolution (Am. Br., p.110 and note * thereto, and cf. Elec. Br., 38). An examination of the legislative history, however, not only fails to bear out the petitioners' contention, but strongly confirms the Commission's view.

The first public utility holding company bill which passed either House was S. 2796 (74th Cong., 1st Sess.). Section 11 (b) (2) of that bill was similar to the first sentence of the present Section 11 (b) (2), except that (as pointed out by the petitioners) it was mandatory that the Commission require each registered holding company and subsidiary "to be reorganized or dissolved" when the Commission found that it violated the standards of that section. Similarly, Section 11 (e) permitted a voluntary plan "for the divestment of control, securities, or other assets, or for the reorganization or dissolution, of such company or any subsidiary company," to meet the standards of Section 11 (b). The bill also contained a Section 11 (b) (3), which provided that within five years all holding companies should cease to be holding companies unless the equivalent of a certificate of convenience and necessity were obtained from the Federal Power Commission.

The elimination of this Section 11 (b) (3) was insisted upon by the House, and the bill which was

reported out by the conference committee and became law omitted that section of S. 2796.[132] It

[132] In their briefs below petitioners made much of the fact that Congressman Mott, who opposed the original S. 2796, spoke in favor of the conference amendment because he said "it effectively eliminates the so-called 'death sentence.'" An examination of the speech made by Mr. Mott makes it clear that what he meant by the "death sentence" was the elimination of all holding companies at the end of five years, provided for in the old Section 11 (b) (3). Thus he stated (Cong. Rec., vol. 79, part 13, pp. 14,169–14,170):

"* * * there was and still is only one real controversial feature in the entire Wheeler-Rayburn bill, * * * and that was and still is subdivision B (3) of section 11 of the Senate version which contained the 'death clause.'

* * * * *

"Again, with the single exception of subdivision B (3), which contained the unconditional, nonreviewable, and unappealable 'death sentence', the remaining portions even of section 11 of the House and Senate bills are identical.

* * * * *

"* * * The sole issue upon the motion to substitute the House for the Senate bill on July 2 arose over the proposed inclusion of subdivision B (3) of section 11 of the Senate bill, * * *.

* * * * *

"The compromise substitute makes judicial review mandatory and does not permit any order to become effective unless the court approves it. We objected to Senate provision B (3), because it arbitrarily put out of business every holding company, without respect to the degree of its remoteness from the operating company, without regard as to whether it was lawful or unlawful, and regardless of whether it was good or bad or whether it was a necessary or an unnecessary holding company."

These last remarks make it clear that Congressman Mott understood that under the conference amendment the Commission was authorized to put a holding company "out of business," but only if it was a "bad" or "unnecessary" holding company.

also changed Section 11 (b) (2) so that, as we have seen, instead of specifying reorganization or dissolution as the remedies, the choice of remedy was left entirely to the Commission, which was to require "such steps" as it might find necessary "to ensure" compliance with the statutory standards. Similarly, Section 11 (e) was changed to permit a voluntary plan, "for the divestment of control, securities, or other assets or for other action by such company or any subsidiary company", to meet the standards of Section 11 (b).

The net result of the compromise between the two houses, therefore, was (1) to delete the *unconditional* provision for the elimination of all holding companies at the end of five years; (2) to substitute the "great-grandfather clause" as a rule of thumb for extreme cases of pyramiding, with the effect of unconditionally eliminating all holding companies beyond the second degree;[133] and (3) to give the Commission, for the rest, flexibility to determine the steps necessary to ensure com-

[133] The "great-grandfather clause," which is the second sentence of Section 11 (b) (2), reads as follows:

"In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company."

pliance by any given holding company with the statutory standards. In other words, the compromise enacted into law by no means forbade dissolution, but simply placed in the hands of the Commission the determination of the steps necessary to ensure compliance with the statutory standards—be the result of those steps liquidation, simplification of the company's capital structure or some other type of reorganization.[134]

Indeed, since Section 11 (b) (2) as first passed by the Senate specifically referred both to *reorganization* and *dissolution,* and since the section as finally enacted contains no specific reference to either reorganization or dissolution, the petition-

[134] See also *In re Standard Gas and Electric Company* (C. C. A. 3, Sept. 14, 1945) where the court said (at p. 4 of the slip opinion):

"It needs no semanticist to be aware that the words 'other action' are broader in meaning than the more connatative and precisely denotative words 'reorganization or dissolution'".

The petitioners' argument is also inconsistent with the fact that Section 1 (c) in both the original S. 2796 and the final Act refers to the "elimination" of holding companies. Section 1 (c) of S. 2796 declares it to be the policy of the Act "to provide at the end of five years for the elimination of the public-utility holding company except as otherwise expressly provided in this title." Section 1 (c) of the Act declares it to be the policy of the statute "to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title." If "elimination" in Section 1 (c) of S. 2796 included dissolution, there seems no reason why the same word in the same context does not have the same meaning in Section 1 (c) of the Act itself.

ers' argument, if valid, would also deprive the Commission of any power to *reorganize* a holding company whose corporate structure is found to violate the statutory standards. However, if the Commission had no power to compel reorganization or dissolution of holding companies, it would be powerless to "ensure" that the statutory standards relating to complex corporate and system structure are met, and these standards would be nullified. Cf. *In re Standard Gas and Electric Company*, p. 163, *supra* (p. 5 of slip opinion).

In practice, the Commission has entered dissolution orders under Section 11 (b) (2) against numerous holding companies, including National Power and Light Company, petitioner's sister company (see p. 19, *supra*), and such other large holding companies as *United Light and Power Co.*, 8 S. E. C. 837;[135] *North American Light and Power Co.*, 10 S. E. C. 924; *Standard Power and Light Corp.*, 11 S. E. C. 689; *Central and Southwest Utilities Co.*, 11 S. E. C. 533; *International Hydro-Electric System*, 11 S. E. C. 888; and *Inter-*

[135] In a dictum in a case arising in the course of a liquidation of United Light and Power Co., the Circuit Court of Appeals for the Second Circuit referred to the Commission's order requiring liquidation and dissolution as being "clearly within the scope of the statute under which the Commission acted." *New York Trust Co.* v. *Securities and Exchange Commission*, 131 F. 2d 274, 275, certiorari denied, 318 U. S. 786. The effect of the order in that case was considered in *Otis & Co.* v. *S. E. C.*, 323 U. S. 624.

national Utilities Corporation, — S. E. C. —, Holding Company Act Release No. 4270 (1943).[136] Under the circumstances, the administrative practice is entitled to weight. *Norwegian Nitrogen Products Co.* v. *United States*, 288 U. S. 294, 315.[137]

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[136] Apart from the instant cases review has been sought from the Commission's orders of dissolution only in connection with Central and Southwest Utilities Co. and International Hydro-Electric system. In neither of these cases, however, was the Commission's right to terminate the existence of a holding company questioned. In each case the Commission's dissolution order was sustained. See *Central and South West Utilities Co.* v. *Securities and Exchange Commission*, 136 F. 2d 273 (App. D. C.); and *Todd* v. *Securities and Exchange Commission*, 137 F. 2d 475 (C. C. A. 6).

[137] See also *United States* v. *American Trucking Associations, Inc.*, 310 U. S. 534, 549; *Skidmore* v. *Swift & Company*, 323 U. S. 134, 140; and *Securities and Exchange Commission* v. *Associated Gas & Electric Company*, 99 F. 2d 795, 798 (C. C. A. 2).

In the last cited case, Judge A. N. Hand, in speaking of the Act herein involved, pointed out, at p. 798: "* * * we are dealing with a new act the administration of which is the peculiar function of the Securities and Exchange Commission. One of the principal reasons for the creation of such a bureau is to secure the benefit of special knowledge acquired through continuous experience in a difficult and complicated field. Its interpretation of the act should control unless plainly erroneous. In no other way can the objects of the act be attained without constant and disconcerting friction."

CONCLUSION

For the reasons stated, the judgment below should be affirmed.

Respectfully submitted.

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APPENDIX A

The Public Utility Holding Company Act of 1935, c. 687, 49 Stat. 803, 15 U. S. C., sec. 79 *et seq.*, provides in pertinent part as follows:

TITLE I—CONTROL OF PUBLIC-UTILITY HOLDING COMPANIES

NECESSITY FOR CONTROL OF HOLDING COMPANIES

SECTION 1. (a) Public-utility holding companies and their subsidiary companies are affected with a national public interest in that, among other things, (1) their securities are widely marketed and distributed by means of the mails and instrumentalities of interstate commerce and are sold to a large number of investors in different States; (2) their service, sales, construction, and other contracts and arrangements are often made and performed by means of the mails and instrumentalities of interstate commerce; (3) their subsidiary public-utility companies often sell and transport gas and electric energy by the use of means and instrumentalities of interstate commerce; (4) their practices in respect of and control over subsidiary companies often materially affect the interstate commerce in which those companies engage; (5) their activities extending over many States are not susceptible of effective control by any State and make difficult, if not impossible, effective State regulation of public-utility companies.

(b) Upon the basis of facts disclosed by the reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session), the reports of the Committee on Interstate and Foreign Commerce, House of Representatives, made pursuant to H. Res. 59 (Seventy-second Congress, first session) and H. J. Res. 572 (Seventy-second Congress, second session) and otherwise disclosed and ascertained, it is hereby declared that the national public interest, the interest of investors in the securities of holding companies and their subsidiary companies and affiliates, and the interest of consumers of electric energy and natural and manufactured gas, are or may be adversely affected—

(1) when such investors cannot obtain the information necessary to appraise the financial position or earning power of the issuers, because of the absence of uniform standard accounts; when such securities are issued without the approval or consent of the States having jurisdiction over subsidiary public-utility companies; when such securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties and upon the basis of paper profits from intercompany transactions, or in anticipation of excessive revenues from subsidiary public-utility companies; when such securities are issued by a subsidiary public-utility company under circumstances which subject such company to the burden of supporting an overcapitalized structure and tend to prevent voluntary rate reductions;

(2) when subsidiary public-utility companies are subjected to excessive charges

for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm's-length bargaining or from restraint of free and independent competition; when service, management, construction, and other contracts involve the allocation of charges among subsidiary public-utility companies in different States so as to present problems of regulation which cannot be dealt with effectively by the States;

(3) when control of subsidiary public-utility companies affects the accounting practices and rate, dividend, and other policies of such companies so as to complicate and obstruct State regulation of such companies, or when control of such companies is exerted through disproportionately small investment;

(4) when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties; or

(5) when in any other respect there is lack of economy of management and operation of public-utility companies or lack of efficiency and adequacy of service rendered by such companies, or lack of effective public regulation, or lack of economies in the raising of capital.

(c) When abuses of the character above enumerated become persistent and widespread the holding company becomes an ageny which, unless regulated, is injurious to investors, consumers, and the general public; and it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems

and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce; and for the purpose of effectuating such policy to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title.

DEFINITIONS

SEC. 2. (a) When used in this title, unless the context otherwise requires—

* * * * *

(7) "Holding company" means—

(A) any company which directly or indirectly owns, controls, or holds with power to vote, 10 per centum or more of the outstanding voting securities of a public-utility company or of a company which is a holding company by virtue of this clause or clause (B), unless the Commission, as hereinafter provided, by order declares such company not to be a holding company; and

(B) any person which the Commission determines, after notice and opportunity for hearing, directly or indirectly to exercise (either alone or pursuant to an arrangement or understanding with one or more other persons) such a controlling influence over the management or policies of any public-utility or holding company as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that such person be

subject to the obligations, duties, and liabilities imposed in this title upon holding companies.

The Commission, upon application, shall by order declare that a company is not a holding company under clause (A) if the Commission finds that the applicant (i) does not, either alone or pursuant to an arrangement or understanding with one or more other persons, directly or indirectly control a public-utility or holding company either through one or more intermediary persons or by any means or device whatsoever, (ii) is not an intermediary company through which such control is exercised, and (iii) does not, directly or indirectly, exercise (either alone or pursuant to an arrangement or understanding with one or more other persons) such a controlling influence over the management or policies of any public-utility or holding company as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that the applicant be subject to the obligations, duties, and liabilities imposed in this title upon holding companies. The filing of an application hereunder in good faith by a company other than a registered holding company shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a holding company, until the Commission has acted upon such application. Within a reasonable time after the receipt of any application hereunder, the Commission shall enter an order granting, or, after notice and opportunity for hearing, denying or otherwise disposing of, such application. As a condition to the entry of any order granting

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such application and as a part of any such order, the Commission may require the applicant to apply periodically for a renewal of such order and to do or refrain from doing such acts or things, in respect of exercise of voting rights, control over proxies, designation of officers and directors, existence of interlocking officers, directors and other relationships, and submission of periodic or special reports regarding affiliations or intercorporate relationships of the applicant, as the Commission may find necessary or appropriate to ensure that in the case of the applicant the conditions specified in clauses (i), (ii), and (iii) are satisfied during the period for which such order is effective. The Commission, upon its own motion or upon application of the company affected, shall revoke the order declaring such company not to be a holding company whenever in its judgment any condition specified in clause (i), (ii), or (iii) is not satisfied in the case of such company, or modify the terms of such order whenever in its judgment such modification is necessary to ensure that in the case of such company the conditions specified in clauses (i), (ii), and (iii) are satisfied during the period for which such order is effective. Any action of the Commission under the preceding sentence shall be by order.

* * * * *

(9) "Holding-company system" means any holding company, together with all its subsidiary companies, and all mutual service companies (as defined in paragraph (13) of this subsection) of which such holding company or any subsidiary company thereof is a member company (as defined in paragraph (14) of this subsection).

* * * * *

POWER TO MAKE PARTICULAR EXEMPTIONS REGARDING HOLDING COMPANIES, SUBSIDIARY COMPANIES, AND AFFILIATES

SEC. 3. (a) The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any holding company, and every subsidiary company thereof as such, from any provision or provisions of this title, unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers, if—

(1) such holding company, and every subsidiary company thereof which is a public-utility company from which such holding company derives, directly or indirectly, any material part of its income, are predominantly intrastate in character and carry on their business substantially in a single State in which such holding company and every such subsidiary company thereof are organized;

(2) such holding company is predominantly a public-utility company whose operations as such do not extend beyond the State in which it is organized and States contiguous thereto;

(3) such holding company is only incidentally a holding company, being primarily engaged or interested in one or more businesses other than the business of a public-utility company and (A) not deriving, directly or indirectly, any material part of its income from any one or more subsidiary companies, the principal business of which is that of a public-utility company, or (B) deriving a material part of its income from any one or more such subsidiary companies, if substantially all

the outstanding securities of such companies are owned, directly or indirectly, by such holding company;

(4) such holding company is temporarily a holding company solely by reason of the acquisition of securities for purposes of liquidation or distribution in connection with a bona fide debt previously contracted or in connection with a bona fide arrangement for the underwriting or distribution of securities; or

(5) such holding company is not, and derives no material part of its income, directly or indirectly, from any one or more subsidiary companies which are, a company or companies the principal business of which within the United States is that of a public-utility company.

(b) The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any subsidiary company, as such, of a holding company from any provision or provisions of this title, the application of which to such subsidiary company the Commission finds is not necessary in the public interest or for the protection of investors, if such subsidiary company derives no material part of its income, directly or indirectly, from sources within the United States, and neither it nor any of its subsidiary companies is a public-utility company operating in the United States.

(c) Within a reasonable time after the receipt of an application for exemption under subsection (a) or (b), the Commission shall enter an order granting, or, after notice and opportunity for hearing, denying or otherwise disposing of such application. The filing of an application in good

faith under subsection (a) by a person other than a registered holding company shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a holding company until the Commission has acted upon such application. The filing of an application in good faith under subsection (b) shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a subsidiary company until the Commission has acted upon such application. Whenever the Commission, on its own motion, or upon application by the holding company or any subsidiary company thereof exempted by any order issued under subsection (a), or by the subsidiary company exempted by any order issued under subsection (b), finds that the circumstances which gave rise to the issuance of such order no longer exist, the Commission shall by order revoke such order.

(d) The Commission may, by rules and regulations, conditionally or unconditionally exempt any specified class or classes of persons from the obligations, duties, or liabilities imposed upon such persons as subsidiary companies or affiliates under any provision or provisions of this title, and may provide within the extent of any such exemption that such specified class or classes of persons shall not be deemed subsidiary companies or affiliates within the meaning of any such provision or provisions, if and to the extent that it deems the exemption necessary or appropriate in the public interest or for the protection of investors or consumers and not contrary to the purposes of this title.

TRANSACTIONS BY UNREGISTERED HOLDING COMPANIES

SEC. 4. (a) After December 1, 1935, unless a holding company is registered under section 5, it shall be unlawful for such holding company, directly or indirectly—

(1) to sell, transport, transmit, or distribute, or own or operate any utility assets for the transportation, transmission, or distribution of, natural or manufactured gas or electric energy in interstate commerce;

(2) by use of the mails or any means or instrumentality of interstate commerce, to negotiate, enter into, or take any step in the performance of, any service, sales, or construction contract undertaking to perform services or construction work for, or sell goods to, any public-utility company or holding company;

(3) to distribute or make any public offering for sale or exchange of any security of such holding company, any subsidiary company or affiliate of such holding company, any public-utility company, or any holding company, by use of the mails or any means or instrumentality of interstate commerce, or to sell any such security having reason to believe that such security, by use of the mails or any means or instrumentality of interstate commerce, will be distributed or made the subject of a public offering;

(4) by use of the mails or any means or instrumentality of interstate commerce, to acquire or negotiate for the acquisition of any security or utility assets of any subsidiary company or affiliate of such holding company, any public-utility company, or any holding company;

(5) to engage in any business in interstate commerce; or

(6) to own, control, or hold with power to vote, any security of any subsidiary company thereof that does any of the acts enumerated in paragraphs (1) to (5), inclusive, of this subsection.

(b) Every holding company which has outstanding any security any of which, by use of the mails or any means or instrumentality of interstate commerce, has been distributed or made the subject of a public offering subsequent to January 1, 1925, and any of which security is owned or held on October 1, 1935 (or, if such company is not a holding company on that date, on the date such company becomes a holding company) by persons not resident in the State in which such holding company is organized, shall register under section 5 on or before December ~~1, 1935 or the thirtieth~~ day after such company becomes a holding company, whichever date is later.

* * * * *

SIMPLIFICATION OF HOLDING-COMPANY SYSTEMS

SEC. 11. (a) It shall be the duty of the Commission to examine the corporate structure of every registered holding company and subsidiary company thereof, the relationships among the companies in the holding-company system of every such company and the character of the interests thereof and the properties owned or controlled thereby to determine the extent to which the corporate structure of such holding-company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power

fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public-utility system.

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

(1) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system: *Provided, however,* That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—

(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;

(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and

(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of

localized management, efficient operation, or the effectiveness of regulation.

The Commission may permit as reasonably incidental, or economically necessary or appropriate to the operations of one or more integrated public-utility systems the retention of an interest in any business (other than the business of a public-utility company as such) which the Commission shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems.

(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any

change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company.

The Commission may by order revoke or modify any order previously made under this subsection, if, after notice and opportunity for hearing, it finds that the conditions upon which the order was predicated do not exist. Any order made under this subsection shall be subject to judicial review as provided in section 24.

* * * * *

(d) The Commission may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce compliance with any order issued under subsection (b). In any such proceeding, the court as a court of equity may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer under the direction of the court the assets so possessed. In any proceeding for the enforcement of an order of the Commission issued under subsection (b), the trustee with the approval of the court shall have power to dispose of any or all of such assets and, subject to such terms and conditions as the court may prescribe, may make such disposition in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing.

Such reorganization plan may be proposed in the first instance by the Commission, or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization.

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section

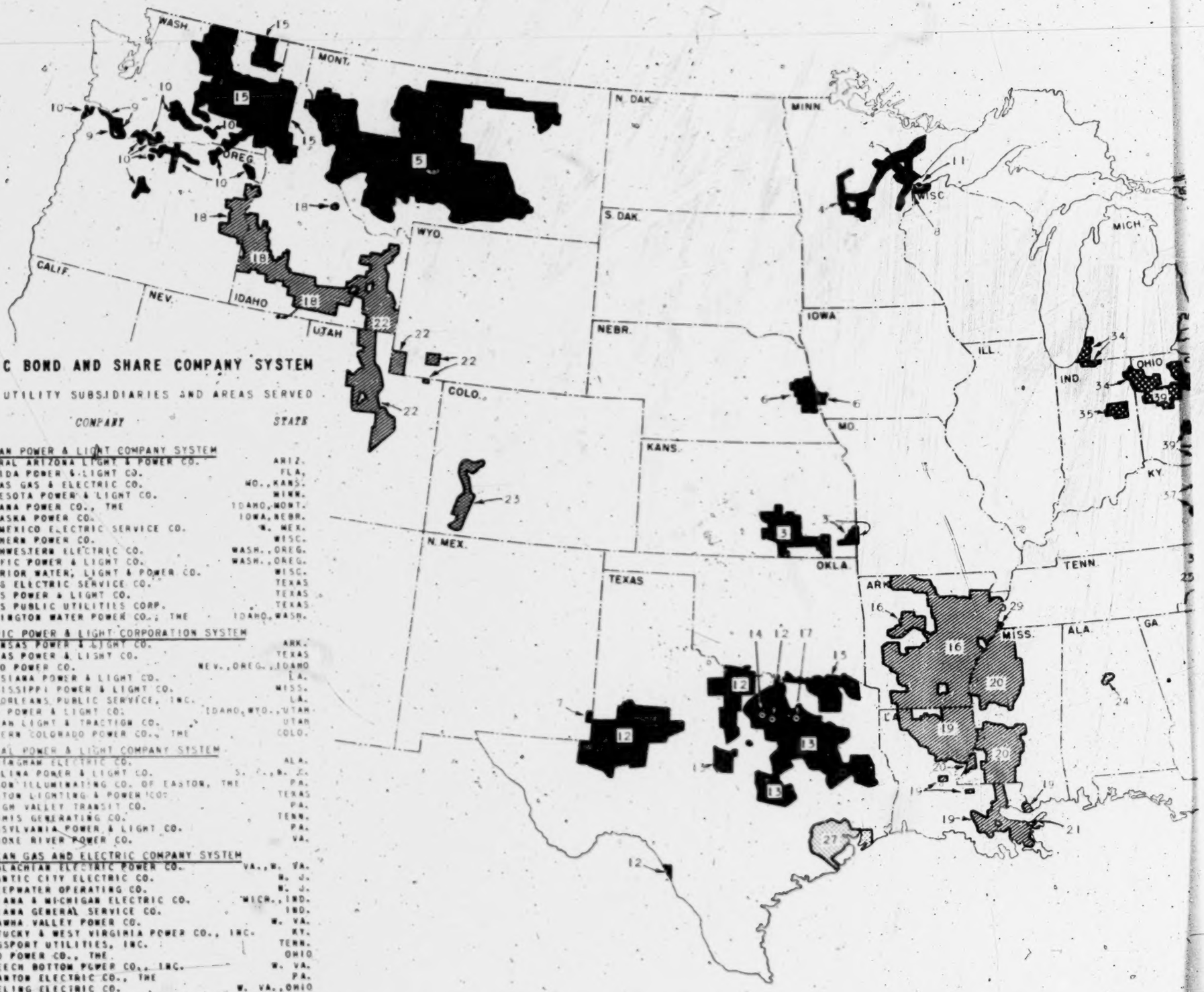
11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

* * * * *

COURT REVIEW OF ORDERS

SEC. 24. (a) Any person or party aggrieved by an order issued by the Commission under this title may obtain a review of such order in the circuit court of appeals of the United States within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith served upon any member of the Commission, or upon any officer thereof designated by the Commission for that purpose, and thereupon the Commission shall certify and file in the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm,

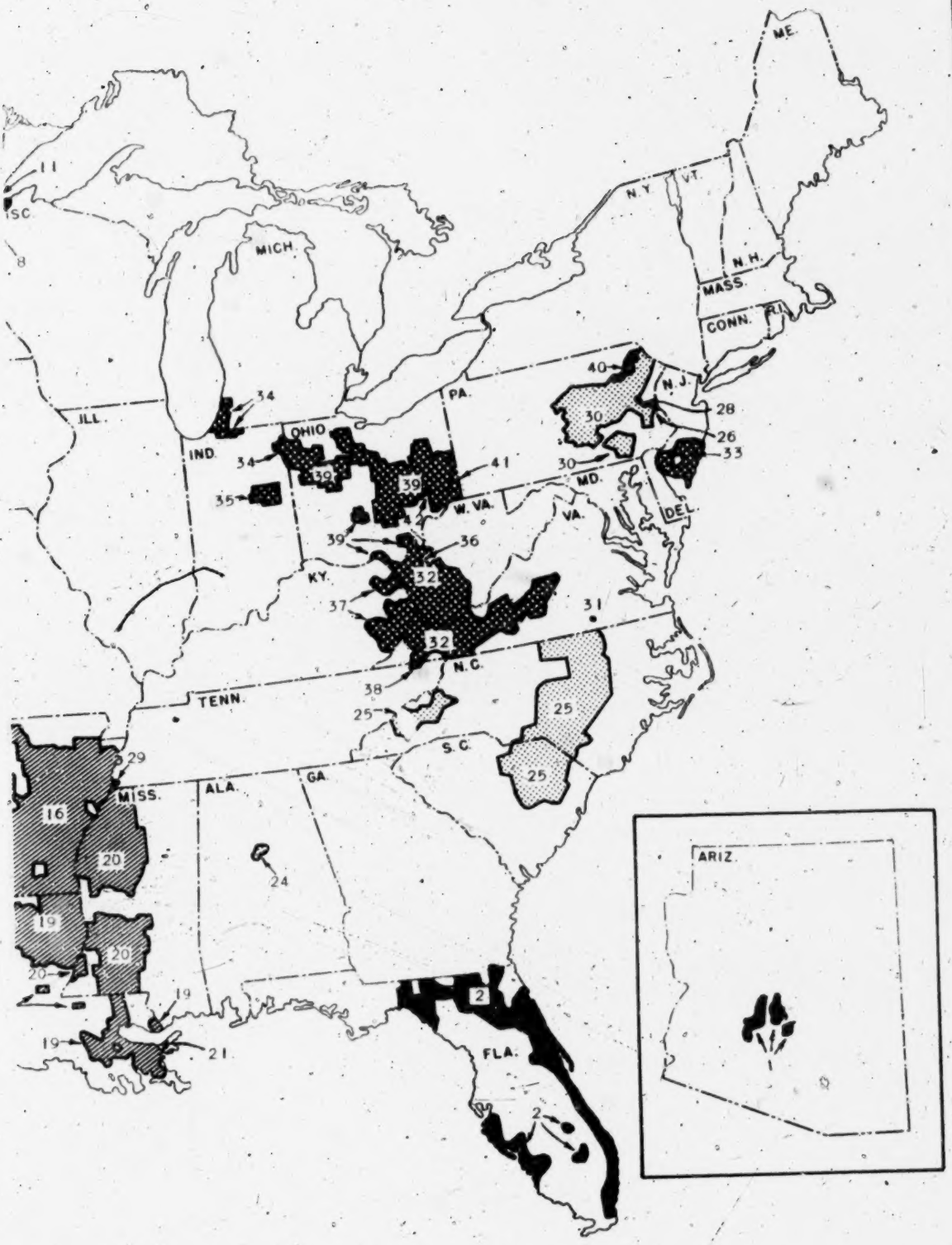
modify, or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission or unless there were reasonable grounds for failure so to do. The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If application is made to the court for leave to adduce additional evidence, and it is shown to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court affirming, modifying, or setting aside, in whole or in part, any such order of the Commission shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).



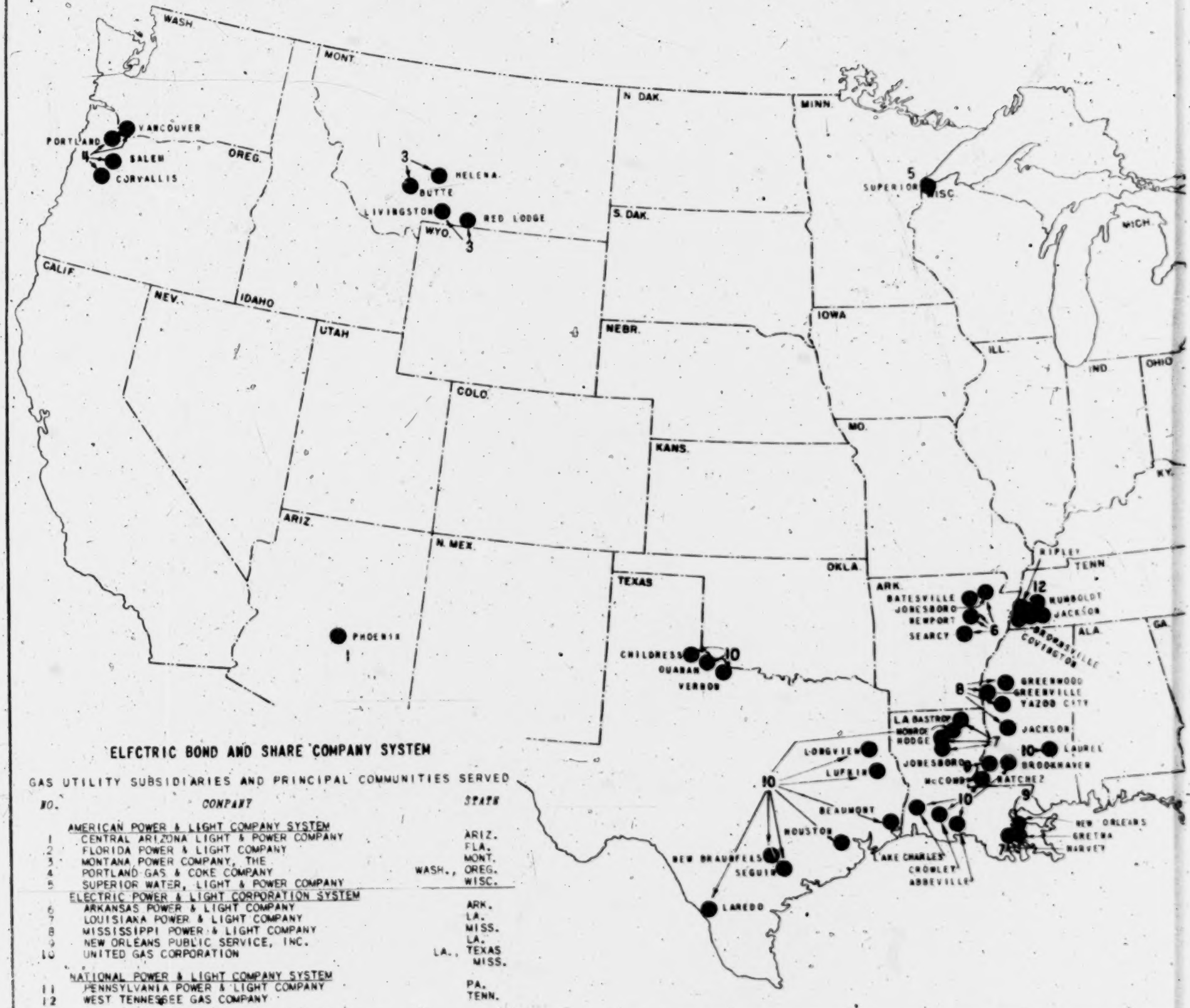
ELECTRIC BOND AND SHARE COMPANY SYSTEM

ELECTRIC UTILITY SUBSIDIARIES AND AREAS SERVED

NO.	COMPANY	STATE
	AMERICAN POWER & LIGHT COMPANY SYSTEM	
1	CENTRAL ARIZONA LIGHT & POWER CO.	ARIZ.
2	FLORIDA POWER & LIGHT CO.	FLA.
3	KANSAS GAS & ELECTRIC CO.	MO., KANS.
4	MINNESOTA POWER & LIGHT CO.	MINN.
5	MONTANA POWER CO., THE	IDAHO, MONT.
6	NEBRASKA POWER CO.	IOWA, NEBR.
7	NEW MEXICO ELECTRIC SERVICE CO.	N. MEX.
8	NORTHERN POWER CO.	WISC.
9	NORTHWESTERN ELECTRIC CO.	WASH., OREG.
10	PACIFIC POWER & LIGHT CO.	WASH., OREG.
11	SUPERIOR WATER, LIGHT & POWER CO.	WISC.
12	TEXAS ELECTRIC SERVICE CO.	TEXAS
13	TEXAS POWER & LIGHT CO.	TEXAS
14	TEXAS PUBLIC UTILITIES CORP.	TEXAS
15	WASHINGTON WATER POWER CO., THE	IDAHO, WASH.
	ELECTRIC POWER & LIGHT CORPORATION SYSTEM	
16	ARKANSAS POWER & LIGHT CO.	ARK.
17	DALLAS POWER & LIGHT CO.	TEXAS
18	IDAHO POWER CO.	NEV., OREG., IDAHO
19	LOUISIANA POWER & LIGHT CO.	LA.
20	MISSISSIPPI POWER & LIGHT CO.	MISS.
21	NEW ORLEANS PUBLIC SERVICE, INC.	LA.
22	UTAH POWER & LIGHT CO.	IDAHO, WYO., UTAH
	UTAH LIGHT & TRACTION CO.	UTAH
23	WESTERN COLORADO POWER CO., THE	COLO.
	NATIONAL POWER & LIGHT COMPANY SYSTEM	
24	BIRMINGHAM ELECTRIC CO.	ALA.
25	CAROLINA POWER & LIGHT CO.	S. C., N. C.
26	EDISON ILLUMINATING CO. OF EASTON, THE	PA.
27	HOUSTON LIGHTING & POWER CO.	TEXAS
28	LEHIGH VALLEY TRANSIT CO.	PA.
29	MEMPHIS GENERATING CO.	TENN.
30	PENNSYLVANIA POWER & LIGHT CO.	PA.
31	ROANOKE RIVER POWER CO.	VA.
	AMERICAN GAS AND ELECTRIC COMPANY SYSTEM	
32	APPALACHIAN ELECTRIC POWER CO.	VA., W. VA.
33	ATLANTIC CITY ELECTRIC CO.	N. J.
	DEEPWATER OPERATING CO.	N. J.
34	INDIANA & MICHIGAN ELECTRIC CO.	MICH., IND.
35	INDIANA GENERAL SERVICE CO.	IND.
36	KANAWHA VALLEY POWER CO.	W. VA.
37	KENTUCKY & WEST VIRGINIA POWER CO., INC.	KY.
38	KINGSPORT UTILITIES, INC.	TENN.
39	OHIO POWER CO., THE	OHIO
	BEECH BOTTOM POWER CO., INC.	W. VA.
40	SCRANTON ELECTRIC CO., THE	PA.
41	WHEELING ELECTRIC CO.	W. VA., OHIO
42	SOUTHERN OHIO PUBLIC SERVICE CO.	OHIO



DS-2293 PREPARED BY SECURITIES AND EXCHANGE COMMISSION

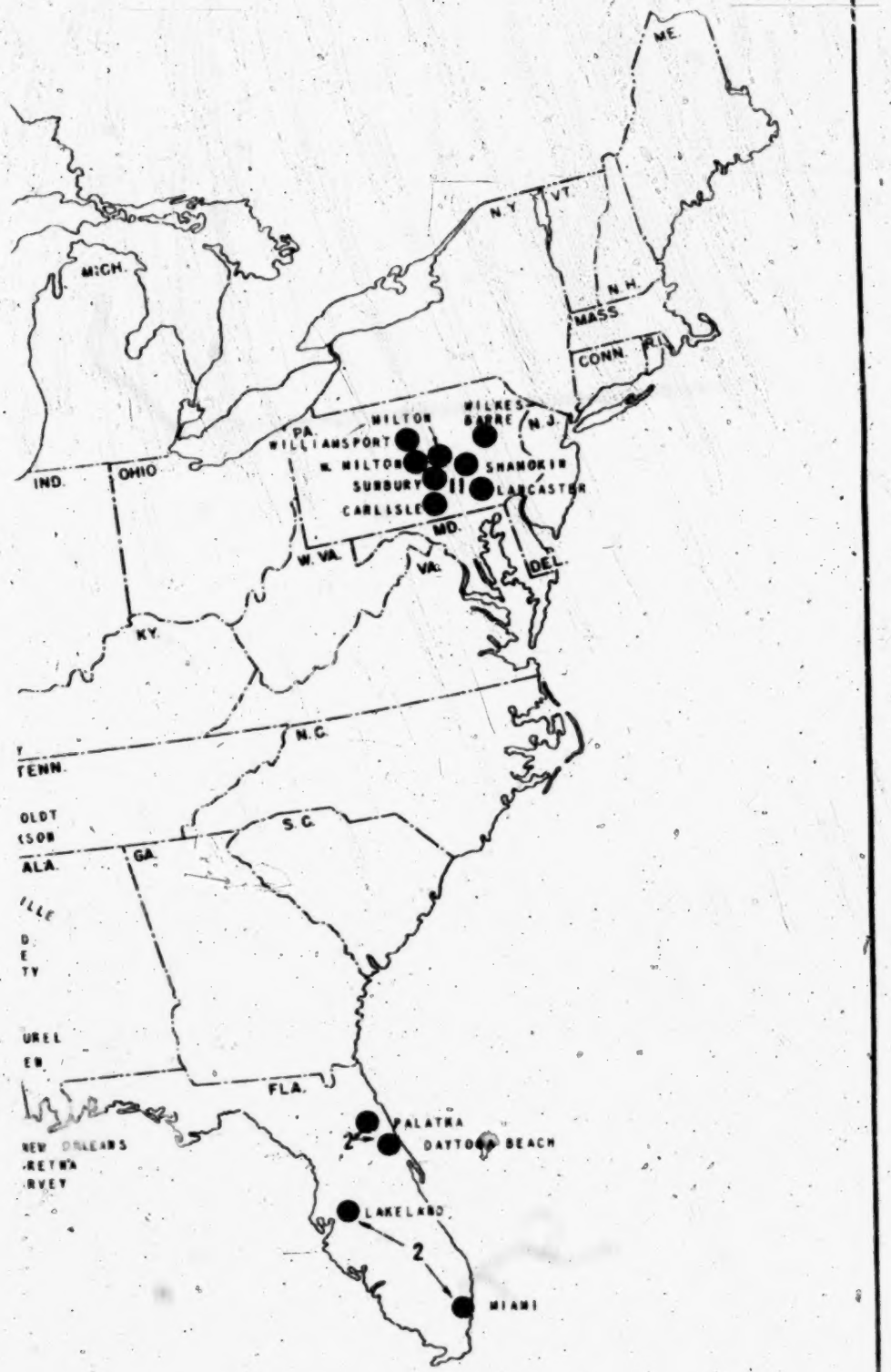


ELFCTRIC BOND AND SHARE COMPANY SYSTEM

GAS UTILITY SUBSIDIARIES AND PRINCIPAL COMMUNITIES SERVED

NO.	COMPANY	STATE
	AMERICAN POWER & LIGHT COMPANY SYSTEM	
1	CENTRAL ARIZONA LIGHT & POWER COMPANY	ARIZ.
2	FLORIDA POWER & LIGHT COMPANY	FLA.
3	MONTANA POWER COMPANY, THE	MONT.
4	PORTLAND GAS & COKE COMPANY	WASH., OREG.
5	SUPERIOR WATER, LIGHT & POWER COMPANY	WISC.
	ELECTRIC POWER & LIGHT CORPORATION SYSTEM	
6	ARKANSAS POWER & LIGHT COMPANY	ARK.
7	LOUISIANA POWER & LIGHT COMPANY	LA.
8	MISSISSIPPI POWER & LIGHT COMPANY	MISS.
9	NEW ORLEANS PUBLIC SERVICE, INC.	LA.
10	UNITED GAS CORPORATION	LA., TEXAS MISS.
	NATIONAL POWER & LIGHT COMPANY SYSTEM	
11	PENNSYLVANIA POWER & LIGHT COMPANY	PA.
12	WEST TENNESSEE GAS COMPANY	TENN.

APPENDIX C

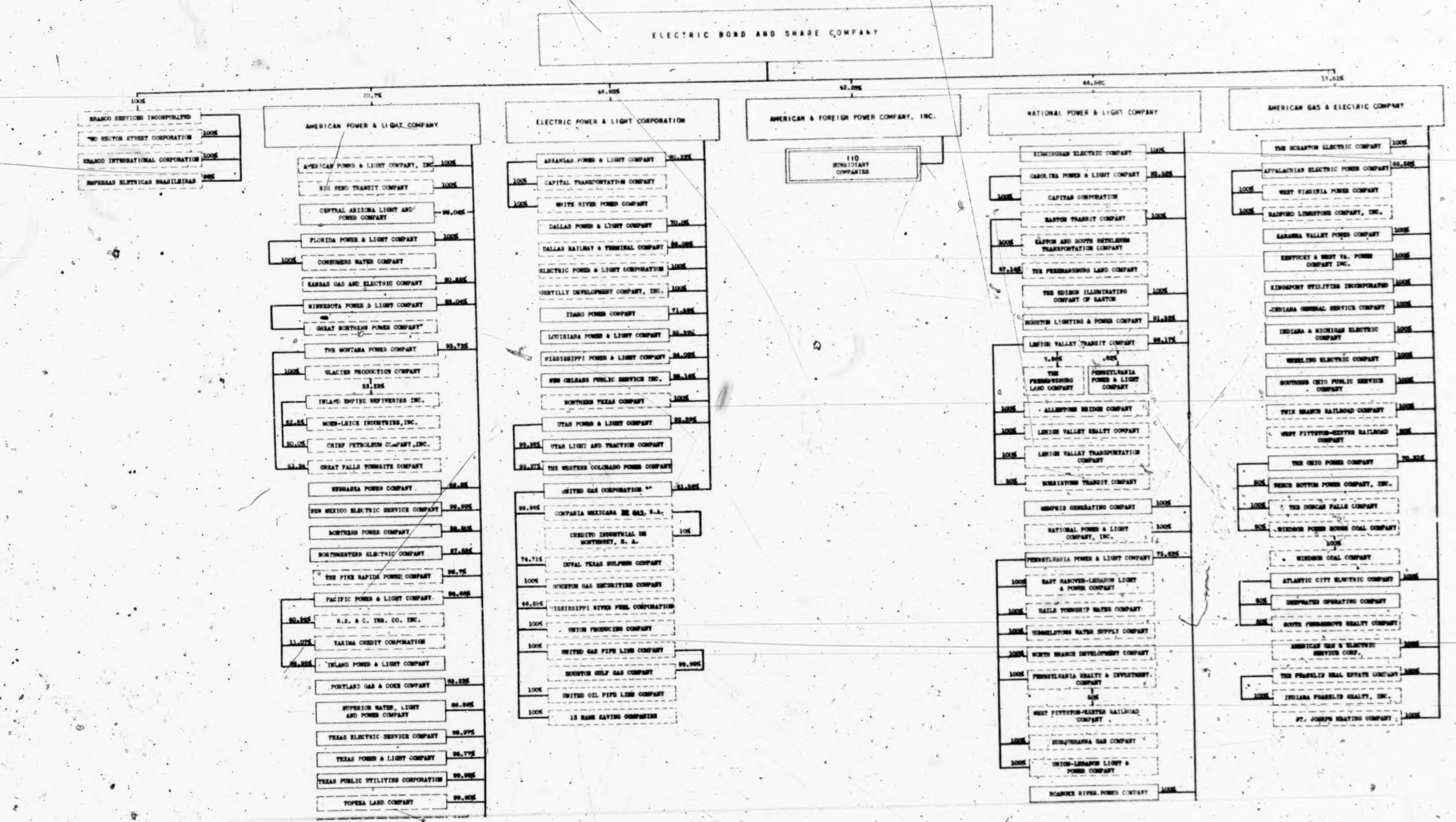


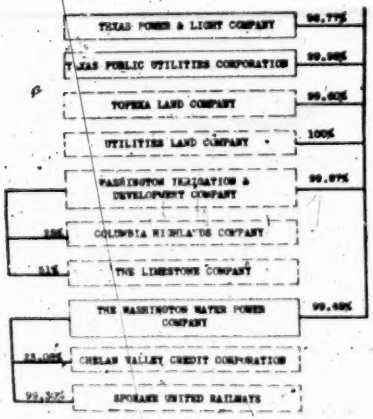
DS-1412 PREPARED BY SECURITIES AND EXCHANGE COMMISSION

APPENDIX D

ELECTRIC BOND AND SHARE COMPANY

CORPORATE CHART SHOWING PERCENTAGE OF VOTING POWER
AS OF DECEMBER 31, 1941



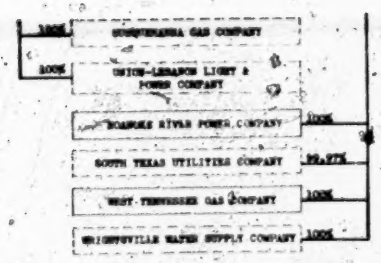


* OUTSTANDING SHARES HELD BY DIRECTORS

** ELECTRIC BOND AND SHARE COMPANY HAS A DIRECT VOTING INTEREST OF 7.19%

HOLDING COMPANY OR [illegible] SUBSIDIARY COMPANY

NON-UTILITY SUBSIDIARY COMPANY



APPENDIX E

STATEMENT OF GANSON PURCELL, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION, BEFORE THE COMMITTEE OF DEPRECIATION OF THE NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS WITH REFERENCE TO THE COMMITTEE'S 1943 DEPRECIATION REPORT (CHICAGO, ILL., MARCH 8, 1944)

On behalf of the Securities and Exchange Commission, I am very happy to take advantage of your invitation to present our views with respect to your 1943 Depreciation Report. The interest of the Securities and Exchange Commission in this subject stems not alone from our duties in administering the Public Utility Holding Company Act but also from our responsibilities under the Securities Act of 1933 and the Securities Exchange Act of 1934, and our functions in reorganization cases under Chapter X of the Bankruptcy Act as amended. The provisions of the Holding Company Act apply to some 52 utility holding company systems, which include 1,217 individual holding, sub-holding and operating companies. The total consolidated assets of these registered companies amount to approximately $16,000,000,000.

While we are interested in sound depreciation practice under each of the statutes I have mentioned, our powers and responsibilities under the Holding Company Act go far beyond the mere disclosure principles of the Securities Act and the Securities Exchange Act. Thus current accruals for depreciation and the size of the depreciation

reserve are matters of particular importance in the decisions that we have to make under the Holding Company Act. They enter into our judgment when we pass upon the issuance and sale of securities, the acquisition or sale of utility securities or assets, and plans of reorganization or recapitalization. Moreover under Section 12 (c) of the Holding Company Act, it is unlawful for any registered holding company or any of its subsidiaries to declare or pay any dividend on any of its securities in contravention of such rules and regulations or orders as the Commission deems necessary or appropriate to protect the financial integrity of companies in holding company systems, to safeguard the working capital of such public utility companies, or to prevent the payment of dividends out of capital or unearned surplus. It is clear that the availability of earnings for dividend distribution is directly affected by the adequacy or inadequacy of current accruals for depreciation and in certain extreme cases such availability may be affected by substantial deficiencies as to past provisions for depreciation. In administering these provisions, we believe it is important to determine whether depreciation is being accrued on a systematic basis related to reasonable estimates of service life.

Turning now to your 1943 Depreciation Report, let me compliment your Committee upon the great contribution that you have made to the literature on this important subject. We have reviewed your report with care and believe that you have presented a most comprehensive analysis of the principles of public utility depreciation. Your

statement of principles, both in the summary of your report and throughout the text, have been written with great clarity and you have exercised painstaking effort to avoid ambiguity and inconsistency. I express the unanimous opinion of the Securities and Exchange Commission when I say that we agree with your principal conclusions and recommendations. In particular, let me say that we believe that straight-line depreciation accounting for public utility companies is the most practicable and desirable method which has been suggested to date. We also feel that it is both practicable and sound to base straight-line computations on age-life studies of depreciable property as modified from time to time by actual experience.

We have considered the effects on investors and consumers of different methods of accruing depreciation and we have concluded that in addition to its other advantages, straight-line depreciation accounting affords greater financial stability to the business unit and greater financial security to the investor than retirement or compound interest methods. As stated in Chapter IX of your report, the depreciation reserve under the straight-line method builds up more rapidly in the earlier years and indeed throughout the life of the enterprise than it does under the interest methods. Accordingly, the use of the straight-line method tends to reduce risks for investors. Furthermore, the direct financial effect of the larger straight-line reserves as compared with compound interest reserves is to reduce the amount of securities that would otherwise be outstanding against the assets of the enterprise throughout its life. These are

important advantages. They signify more conservative financial policy than has frequently prevailed in the past. We, therefore, believe that the change-over to straight-line depreciation accounting will afford a greater protection of the financial integrity of public utility companies and thereby strengthen their credit standing.

There is one subject concerning which I should like to make special comment, namely, the problems involved in the change-over from retirement to straight-line depreciation accounting. On this subject, certain spokesmen of the public utility industry have expressed considerable apprehension lest the change-over be required in an unduly abrupt manner with adverse effects upon the credit of the companies. They have also urged that your recommendations would involve retroactive features unfair to investors from the point of view of rate regulation. The objections of the various industry committees are summarized in the memorandum submitted by the Depreciation Committee of the Edison Electric Institute as follows:

> "1. In accounting, the books of account would ordinarily be adjusted to conform with whatever theoretical computations are selected as 'proper'.
>
> "2. In financing or reorganization cases, the adjusted reserve as above, or an equivalent theoretical reserve computation, would be used in determining the amount of securities permitted to be issued or to remain outstanding.
>
> "3. In rate making proceedings, the theoretically computed reserve would be used as the measure of depreciation in establish-

ing a depreciated rate base; and a corresponding annual accrual on an age-life basis would be used in determining the allowed return."

These statements appear to give inadequate weight to certain passages in your report which clearly reflect your judgment that the objective of correcting inadequate reserves should be approached with due regard for what is equitable and feasible under all of the circumstances of the individual case.

While the three aspects of the change-over problem, namely, accounting, financing and rate making, are interrelated to a great extent, I shall confine my comments to the accounting and financing phases with respect to which we have had some experience under the Holding Company Act. Since we have no rate making duties, I shall not attempt to comment on that particular phase of the problem. As to the remaining aspects of the change-over problem—accounting and financing—our Commission has taken into account the fact that there has been a substantial change in thinking as to proper depreciation practices both on the part of the industry and the regulatory authorities. Accordingly we have tended to require a gradual rather than an abrupt change-over to straight-line depreciation.

Perhaps some of the experience that we have had in connection with refundings and with reorganizations, both formal and informal, may throw some light on an approach which we have found to be feasible and beneficial to the companies, their security holders and the public gen-

erally. Usually when a utility reorganization case is before us, we find that not one but a number of financial and accounting matters require correction. These may include inadequate depreciation reserves, inflationary items that must be eliminated and excessive senior securities that must be scaled down. While there are certain objective standards toward which we aim, we have found as a practical matter that we attain or fall short of our goal depending upon the ingredients with which we have to work in the particular case. The diversity of results reached, with respect to depreciation and debt ratios for example, is due to the difference in practical obstacles from case to case. I may say that with the cooperation of the companies concerned, the application of that method has been most successful. In all such cases, the more important defects have been eliminated and where it has not been feasible to obtain an ideal financial structure immediately, provision has been made for the transition to that goal over a period of years.

In the case of debt financing it is usually customary to provide for a maintenance and depreciation fund in the mortgage indenture. Its purpose is to assure as certainly as possible that the amount of net property securing the mortgage will not decrease and thereby distort the ratios of bonds to net property contemplated in the mortgage. The kind of provision that is necessary in any given situation to provide for adequate maintenance and depreciation is difficult to determine. There has been no unanimity of opinion as to how such a calculation should be made. In the majority of

cases it has been customary to use a percentage of gross revenue as the sum necessary for this purpose in the absence of a more satisfactory basis. Generally, 15 percent of gross revenues is specified as the amount which must be accounted for to the trustee of the mortgage for maintenance and depreciation. Under the increased revenues of the war period this percentage has resulted in a substantial increase in depreciation reserves. I think it should be realized, however, that while these indenture provisions generally serve the purpose for which they are intended, they are not, except as a matter of coincidence, the equivalent of a systematically determined provision for depreciation and maintenance.

It has been our experience that the application of the foregoing policies has materially improved the financial condition of the utility companies concerned. This has been accomplished not only without burden to their security holders and their consumers but with positive benefits to them.

Let me give you a few illustrations from our experience which will indicate some of the specific improvements that have been made with respect to depreciation policy. In connection with a refunding program by a large electric utility system, the depreciation reserve was increased from $10,800,000 or 4.01 percent of its plant account to $23,900,000 or 10.1 percent of total plant. I may also add that in the case of this company the annual accrual for depreciation increased from $1,724,000 in 1936 to $4,491,000 in 1942. In other such cases depreciation reserves were increased from 6.9 percent of total property to 11.12 percent

in one case; from 5.89 percent to 8.77 percent in another; and from 1.35 percent to 11.5 percent in still another case. Numerous other illustrations can be cited to show the extent to which depreciation reserves in the electric utility industry have improved, especially over the past six years. The over-all figures for the private electric utility industry show that depreciation reserves increased from $1,495,000,000 on December 31, 1937 to $2,306,000,000 on December 31, 1942. On the earlier date, such reserves were 10.8 percent of the total plant account and at the end of 1942 that ratio had increased to 15.5 percent. As the Federal Power Commission has pointed out, annual depreciation and amortization charges increased by nearly $100,000,000, or 40 percent, from 1937 to 1942. This represented an increase in the average annual rate of accrual from 1.7 percent of total utility plant in 1937 to 2.2 percent in 1942.

I have referred earlier to the industry's fears that your recommendations would involve unfair retroactive regulation. As I have said, we believe that such expressions of concern are not justified by a fair reading of your report. Nevertheless we do recognize that there are problems with respect to the changeover from retirement to straight-line depreciation accounting both as to the timing of its accomplishment and as to its effects upon investors and consumers. As you have pointed out in your report, it may not be practicable to draft a uniform rule in this regard to cover all cases. I think, however, that it would be advantageous if you were to extend your

analysis of the change-over problem to indicate certain principles that should be followed in various types of situations. In this connection, to cite the experience of our Commission under the Holding Company Act, we have found in financing and reorganization cases that these problems can be resolved by a gradual approach and in a manner that achieves important improvements on a fair and equitable basis with lasting benefits to investors and consumers.

Appendix F

Securities and Exchange Commission,
Philadelphia 3, June 21, 1945.

Re: Minnesota Power & Light Company, American Power & Light Company, File No. 54–101; Minnesota Power & Light Company, American Power & Light Company, File No. 59–75

American Power & Light Company,
Two Rector Street, New York City.

Gentlemen: In response to your letter of April 11, 1945, and in accordance with my previous letter to you dated July 12, 1944 I hereby inform you that the Commission, after consultation with the Solicitor General, agrees that in its opinion the making of the above-entitled filing and the consummation of the transactions contemplated therein do not constitute, and the Commission will not claim that they constitute, an estoppel or waiver by the company of any contentions it has raised in the proceedings in the United States Supreme Court in *American Power & Light Company* v. *Securities and Exchange Commission,* No. 166, 1944 Term.

The above undertaking is without prejudice to the right of the Commission or the Solicitor General, or their representatives, to make any contention, argument or assertion which they would have been in position to make in the absence of the

steps which may be taken by your company or its subsidiaries referred to above. Furthermore, the above undertaking shall not preclude the Commission or the Solicitor General, or their representatives, from presenting by brief or oral argument any facts which may be pertinent to issues before the Court in the pending litigation and we may deem it appropriate to include this letter in any brief which we submit to the Court.

Sincerely yours,

GANSON PURCELL,
Chairman.

U. S. GOVERNMENT PRINTING OFFICE: 1945